GOVERNMENT COMPETITION WITH SMALL BUSINESS

HEARING

BEFORE THE

SUBCOMMITTEE ON MONETARY AND FISCAL POLICY

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

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GOVERNMENT COMPETITION WITH SMALL BUSINESS

WEDNESDAY, OCTOBER 28, 1981

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON MONETARY AND FISCAL POLICY
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9 a.m., in room 6226, Dirksen Senate Office Building, Hon. Roger W. Jepsen (chairman of the subcommittee) presiding.

Present: Senators Jepsen and Symms, and Representatives Reuss and Richmond.

Also present: James K. Galbraith, executive director; Bruce R. Bartlett, deputy director; Louis C. Krauthoff II, assistant director; Charles H. Bradford, assistant director; and Robert Premus, professional staff member.

OPENING STATEMENT OF SENATOR JEPSEN, CHAIRMAN

Senator **JEPSEN**. Good morning. I wish to welcome the Honorable David A. Stockman here this morning. It is an honor, sir, especially with your busy schedule. You hear this said about all public office officials, but in this case I know it is really true. I thank you for taking the time to be with us this morning.

The economist George Gilder notes that small business operators are the ones who are "fighting America's only serious war against poverty." A casual look at the Fortune 500 or even the Fortune 1,000 will tell you that most of these big firms have experienced little job growth.

Meanwhile, between 1969 and 1976, a Commerce Department study shows that smaller firms created 7.4 million new jobs.

A partial reason for the success of these entrepreneurs is the strong competition that exists at that level of commerce.

I suspect that small business, like every other part of the private sector, will soon be benefiting from the Reagan administration's efforts to remove the cold hand of Government from profitmaking, nongovernment operations.

Today we are here to discuss one dimension of the problems caused by Government when it attempts to compete with cheaper and more efficient segments of the private sector.

Most of us would agree that Government acts in the public's best interest as defender of our national security or as a lawmaker. But I harbor some doubts about Uncle Sam as a printer, tiremaker, or data processor.

According to one recent study, some 40,000 Federal employees now perform 11,000 commercial or industrial services that could be done by private firms. The Chamber of Commerce of the United States has estimated that those services cost taxpayers an additional $19 billion because they were performed by Government.

Another study by James T. Bennett and Mahnwell H. Johnson, both professors from George Mason University, found that a "bureaucratic rule of two" can be applied when comparing Government to private sector costs for particular goods and services. In other words, Government usually ends up spending twice as much as a private firm for performing the same task.

Along with the many other sound measures implemented by this administration, I am encouraged by the commitment it is showing to circular A-70, a measure designed to shift much of the work I've described here to private sector contractors.

I am pleased to welcome OMB Director David Stockman here today to elaborate on what the administration has done in this area and what we can expect in the future to shift Government services to the private sector where practical.

Later in this hearing we will hear testimony from Milton Stewart, editor of Inc. Magazine, a respected journal which chronicles the various trials and tribulations of operating a small business. If, as George Gilder says, small business is fighting the most effective war against poverty, then Mr. Stewart is a leading general and strategist in that important battle.

And, finally, I look forward to hearing from Mr. Collison from my home State of Iowa. He will give us some first-hand examples of this problem. I look forward to his thoughts.

I would advise my distinguished colleagues that Director Stockman respectfully requested that he would like to be able to leave by 10 a.m. and so I will now defer to my distinguished chairman of the Joint Economic Committee, Congressman Reuss, for any remarks he may have.

Representative REUSS. Thank you, Mr. Chairman, and they will be very brief and confined to congratulating you, sir, for calling this meeting on what is surely one of our most important concerns, the competition by Government with and against frequently small business. It's going to be a good hearing.

Senator JEPSEN. Senator Symms, do you have any comments?

Senator SYMMS. No comments. I welcome Mr. Stockman and look forward to hearing from him.

Senator JEPSEN. Senator Hawkins could not attend this morning's hearing, therefore I will, without objection, place her written opening statement in the record at this point.

[The written opening statement of Senator Hawkins follows:]

WRITTEN OPENING STATEMENT OF SENATOR HAWKINS

Congress, working with our President, has been in the process of reducing the omnipresence of Government in the lives of Americans. For the first time since World War II, we have succeeded in reducing increases in Federal Government spending. I think that the President and OMB Director, David Stockman, deserve a great deal of credit for that achievement.

But, establishing Federal fiscal responsibility will take time and will require sensitive assessment and intelligent pruning of the Federal establishment.

We must begin by removing impediments, such as "paper work hurdles," to productive economic activity. Information overkill often adds only to the cost of business, without producing comparable public benefits. One way of reducing Government spending is to privatize some now-governmental functions.

Too often the presence of a Government activity curtails what could be done more efficiently by the private sector.

We support the administration's objectives of encouraging competition with Government agencies so as to improve efficiency and lower costs. Let me cite the Rural Electrification Administration [REA] as an example of a Government-subsidized operation badly in need of competition.

Initially REA was to bring telephone service and electric power to rural America. Best estimates now are that 99 percent of this task is done; what remains is updating and upgrading equipment. REA receives guarantees for loans through the Treasury's Federal Financing Bank [FFB]. These loans are given various rural telephone and electric cooperatives at rates from 2 to 5 percent. The FFB, however, must borrow at the going interest rate.

The total appropriated for fiscal year 1982 for the REA loan program is about $1.2 billion, to be lent predominantly at 2 and 5 percent rates.

Thus the subsidy cost of this single program to the Treasury could be over $130 million. And evidence is mounting that the costs of the REA itself could be reduced by improving competitive practices with respect to contracts and procurement.

We cannot place enough emphasis on the importance of rekindling competition in the American economy. Too many examples exist where Government intrusion has stifled industry, competition, and productivity. We have begun the process of reversing this intrusion.

Senator JEPSEN. Mr. Stockman, you may proceed.

STATEMENT OF HON. DAVID A. STOCKMAN, DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET

Mr. STOCKMAN. Thank you, Mr. Chairman, I'm delighted to have this chance to participate in your hearings. I have a rather lengthy prepared statement that I would like to submit for the record and, with your permission, I would like to summarize the highlights of how we're going to implement A-76.

Senator JEPSEN. Without objection, your prepared statement will be placed in the hearing record. The Chair hears none and so orders. You may proceed.

Mr. STOCKMAN. Mr. Chairman, let me begin by observing that competition is a basic allocative mechanism in our economy and with vigorous competition the customer gets the best product at the lowest price. When the millions of competitive transactions that occur in our economy each and every day are added up, we have allocated the Nation's resources in a reasonably efficient manner, thereby boosting that output, raising real incomes and wealth, and improving our living standards.

Small businesses play a crucial role in competition. By definition, today's big business began as small businesses with a better idea. Indeed, as you have noted in your opening comments, it is often small businesses which do have the better idea—which are the most adventuresome innovators, which find a more efficient way to deliver a service or create a good or invent a new technology or stimulate a new market. The constant quest for greater efficiency and innovation by small business is a vital national resource which we must protect from mindless Government intervention, whether through regulation or so-called competition from Government, the topic of these hearings.

Mr. Chairman, when we talk about the impact of Government competition on small business, we are essentially raising the issue as to whether or not the Federal Government should provide goods and services to itself or to allow others to compete to provide those goods and services. In other words, one of the major competitors is also the customer and that competitor/customer has for practical purposes unlimited resources and powers to influence the buying decision.

For that reason, OMB's Circular No. A-76 endeavors to bring balance into that equation and separate the dual role of purchaser and supplier which is inherent in agency operations and governmental functions. The A-76 policy provides for a general policy of reliance on competitive private enterprise for commercial or industrial products and services required by the Government. A-76 also lays out the analytical procedures for determining whether it costs the Government less to produce a good or service internally or to purchase it from the private sector.

This emphasis on the private sector is not simply an abstract philosophic commitment to free enterprise, although it is partially that as well, but it represents a practical acknowledgement of our fiduciary responsibility to the American taxpayer to make the most efficient possible use of his tax dollar for the purposes authorized by the Congress.

Competition for government business fosters efficiency, economy, and increased productivity in the Federal Government. The Defense Department's experience in the last 3 years or so of vigorously implementing A-76 proves the case in my mind beyond all doubt. A total of more than 440 cost studies were conducted by the three military services. In those, 60 percent, or more than 164, of these studies involving 11,000 full-time jobs resulted in a decision to convert to private sector contractors. The savings are projected to be nearly $100 million annually. To take another example, a recent GAO report on GSA's cleaning costs found that their inhouse costs are needlessly higher than the private sector. The GAO estimated that in four regions studies GSA could have saved approximately $16 million during 1980 had it contracted for cleaning services being done by its own custodian employees.

We estimate that the Government currently operates thousands of commercial or industrial activities with an annual operating cost in excess of $20 billion and with a similar amount of capital investment backing those activities. The vast majority of these activities have never been subject to competition. If these activities were subject to the cost comparison studies required by A-76, we estimate that 154,000 personnel spaces could be converted to contract operations with a 5-year cumulative savings between 1982 and 1987 in excess of $3 billion, and I would mention that that's in constant 1981 dollars, so that on an annualized basis those figures would grow substantially over time. Moreover, these savings would continue to accrue each and every year thereafter.

The potential for such savings has been recognized for a long time. Since 1955, each administration has expressed a general policy of reliance on the private sector for services needed to support the accomplishment of agency missions. The most recent expression of that policy was published in revisions to A-76 in 1979.

For our own part, the Reagan administration strongly supports the general policy of reliance on competitive private enterprise and has vigorously embraced it as evidenced by the following actions and processes that we have underway already.

First, the President reaffirmed his support of this program in the March 1982 budget revisions. Shortly thereafter, a memorandum and series of letters went to each of the major agencies and departments in April of 1981 reaffirming the policy and requiring a series of specific steps to be taken by way of inventorying industrial and commercial activities and developing schedules for the implementation of cost studies to see what additional activities could be contracted out. Third, the OMB bulletin was sent to all executive agencies and departments requiring that they submit detailed information on their implementation of the program and its impact on future budget submissions, and I would like to stress this. Mr. Chairman, because we are making an effort to integrate these cost savings into the annual budget process in order to highlight and keep the pressure on the agencies to move forward with A-76 implementation and to demonstrate in bottom line budget dollar terms the value of this program.

In June of this year, circular No. A-11 was revised further to strengthen linkages between budget submissions and agencies' overall implementation of A-76.

We would welcome a clear statement of intent by the Congress in support of the policy that the Government should not compete with the private sector. A-76 policy has been applied unevenly over several administrations and it is now time to make it work in a vigorous and effective and determined way. We believe that the proposed Senate Joint Resolution 93, introduced by Senator Hayakawa on June 22, 1981, is an excellent means to clarify and reaffirm this as a national policy on A-76.

Mr. Chairman, I would like to point out that our obligation to achieve efficiency in the procurement of industrial and commercial services requires an obligation of fairness—fairness of ongoing government activities and their employees, and that is addressed by four specific instructions in A-76.

First is the requirement that when a contract for services expires, it must be reviewed to determine if it is still cost effective.

Second, requiring agencies to make complete information available to all interested parties. Data such as inventories, review schedules, and results of reviews is made available to all interested parties, including affected Government employees and Government unions.

Third, instructing each agency to establish a procedure for review of all appeals submitted by affected parties. The procedure must provide for an expeditious ruling by an official of equal or higher level than the official approving the original decision.

And, fourth, encouraging agencies to reorganize in-house activities for maximum efficiency prior to making a cost comparison with the proposed contract performance.

Moreover, A-76 provides that each contract awarded for work previously performed in-house include a clause giving displaced Government employees a right of first refusal of employment with the contractor for positions in which they are qualified.

The circular further recognizes in its implementation those Federal laws and policies which directly impact it. Specifically, all private sector service contract employees must be paid at least the wages and fringe benefits prevailing for similar work in the locality, as determined by the Department of Labor; second, employment preference must be given under private sector contracts to disadvantaged persons and veterans, comparable to requirements which exist for Federal employment.

We recognize that the implementation of the policy as it is presently written, which requires that cost comparisons be conducted to determine if any activity should be continued in-house or converted to a contract operation, may be viewed by the private sector as cumbersome and perhaps inefficient.

Because we have recently found some inequities and cumbersome procedures, such as excess paperwork and so forth in cost studies, OMB is beginning a reexamination of the current cost comparison methodology to streamline it and make it as efficient as possible to remove any practical barriers to increased implementation of A-76 in contracting out commercial industrial activities.

Some areas that will be reexamined are the following:

First, establishing a policy that all new starts, new governmental missions or activities for newly authorized programs, unless they are inherently governmental, will be performed by the private sector.

Another possibility that we are looking at is streamlining the cost comparison process for relatively small dollar or small volume activities under $1 million so that these could be contracted out without a full range of activities required before that decision at the present time.

Third, raising the current $100,000 threshold at which cost studies must be conducted to recognize inflation over the last several years and allow for small dollar activities to be contracted out without cost studies.

Fourth, reexamining standard cost factors that are used today and the possible addition of new ones in such areas as overhead rates; and reexamining the present cost differentials which give preference to continuation of in-house activities.

Another would be to reevaluate the cost figures for Government employee benefits.

In the interim and in addition to these, we will be issuing an immediate change in the circular covering the following areas:

One, a standard methodology for developing a performance-oriented description of the Government's requirements, rather than a detailed description, that will be published as a supplement to the circular.

Methodology changes will be made to the cost comparison procedures in such areas as:

First, deleting the requirement that the Government always calculate material, facility, and equipment costs even when those costs will be exactly the same for the Government and the contractor. That generates unnecessary paperwork and should be avoided and could facilitate the process.

Streamlining the computation method which is complex for underutilized Government capacity.

Third, developing new guidelines for computation of one-time conversion costs related to personnel such as severance costs.

And, finally, developing guidelines to streamline the effort for computation of detailed costs.

In summary, Mr. Chairman, let me state that this administration fully supports the competitive free enterprise system. Small businesses, in particular, provide the spark which enhances competition and, therefore, makes the most efficient use of our Nation's resources. Thus, we need a strong A-76 program and, more importantly, we need a strong reaffirmation by Congress of a policy of relying on the private sector for goods and services. The kind of reaffirmation of this resolution which we find in proposed Senate Joint Resolution 93 is exactly what is needed at the present time.

Those conclude my remarks, Mr. Chairman. I would be very happy to take your questions and questions by members of the committee.

Senator **Jepsen**. Thank you, Mr. Stockman.

[The prepared statement of Mr. Stockman follows:]

PREPARED STATEMENT OF HON. DAVID A. STOCKMAN

THANK YOU FOR INVITING ME HERE TODAY. I APPRECIATE THE OPPORTUNITY TO PRESENT THIS ADMINISTRATION'S VIEWS ON THE IMPACT OF GOVERNMENT COMPETITION ON SMALL BUSINESS THROUGH THE IMPLEMENTATION OF OMB CIRCULAR NO. A-76 IN THE EXECUTIVE BRANCH.

COMPETITION IS A VERY IMPORTANT CONCEPT, BECAUSE IT IS THE BASIC ALLOCATIVE MECHANISM IN OUR ECONOMY. COMPETITION SHOULD MEAN THAT THE CUSTOMER GETS THE BEST PRODUCT AT THE LOWEST PRICE. IT SEEMS AXIOMATIC THAT THE MORE COMPETITORS THERE ARE THAT A CUSTOMER HAS TO CHOOSE FROM, THE MORE LIKELY IT IS THAT THE CUSTOMER WILL GET THE BEST BUY. WHEN ALL OF THESE TRANSACTIONS ARE ADDED UP, WE HAVE ALLOCATED THE NATION'S RESOURCES IN A REASONABLY EFFICIENT MANNER.

SMALL BUSINESSES PLAY A VERY IMPORTANT ROLE IN COMPETITION. BY DEFINITION, TODAY"S BIG BUSINESSES BEGAN AS SMALL BUSINESSES WITH A BETTER IDEA. INDEED, IT IS OFTEN SMALL BUSINESSES WHICH DO HAVE

THE BETTER IDEA -- WHICH ARE THE MOST ADVENTURESOME INNOVATORS, WHICH FIND A MORE EFFICIENT WAY TO DELIVER A SERVICE OR CREATE A GOOD. THE CONSTANT QUEST FOR GREATER EFFICIENCY AND INNOVATION BY SMALL BUSINESSMEN AND WOMEN IS A VITAL NATIONAL RESOURCE WHICH WE MUST PROTECT FROM MINDLESS GOVERNMENT INTERVENTION WHETHER THROUGH REGULATION OR SO-CALLED "COMPETITION" FROM GOVERNMENT.

WHEN WE TALK ABOUT THE "IMPACT OF GOVERNMENT COMPETITION ON SMALL BUSINESS," WE SHOULD REALIZE THAT WE ARE MISUSING THE WORD "COMPETITION" IN THIS CONTEXT. A DICTIONARY DEFINITION (WEBSTERS SEVENTH COLLEGIATE DICTIONARY) SHOWS THAT COMPETITION INVOLVES THE "EFFORTS OF TWO OR MORE PARTIES TO SECURE THE BUSINESS OF A THIRD PARTY BY THE OFFER OF THE MOST FAVORABLE TERMS."

IN THIS CONTEXT WE ARE TALKING ABOUT THE FEDERAL GOVERNMENT DECIDING WHETHER OR NOT TO PROVIDE GOODS AND SERVICES TO ITSELF OR TO ALLOW OTHERS TO COMPETE TO PROVIDE THOSE GOODS AND SERVICES. IN OTHER WORDS, ONE OF THE MAJOR COMPETITORS IS ALSO THE CUSTOMER AND THAT COMPETITOR/CUSTOMER HAS FOR PRACTICAL PURPOSES UNLIMITED RESOURCES AND POWERS TO INFLUENCE THE BUYING DECISION.

OMB'S CIRCULAR NO. A-76 ENDEAVORS TO BRING MEANING BACK TO THE WORD COMPETITION WHERE IT INVOLVES THE GOVERNMENT. A-76 STATES THE GENERAL POLICY OF RELIANCE ON COMPETITIVE PRIVATE ENTERPRISE FOR COMMERCIAL OR INDUSTRIAL PRODUCTS AND SERVICES

REQUIRED BY THE GOVERNMENT. A-76 ALSO LAYS OUT THE ANALYTICAL PROCEDURES FOR DETERMINING WHETHER IT COSTS THE GOVERNMENT LESS TO PRODUCE A GOOD OR SERVICE INTERNALLY OR TO PURCHASE IT FROM THE PRIVATE SECTOR.

THIS EMPHASIS ON THE PRIVATE SECTOR IS NOT A MINDLESS PHILOSOPHIC COMMITMENT TO "FREE ENTERPRISE," BUT IT REPRESENTS AN ACKNOWLEDGMENT OF OUR FIDUCIARY RESPONSIBILITY TO THE AMERICAN TAXPAYER TO MAKE THE MOST EFFICIENT POSSIBLE USE OF HIS TAX DOLLAR FOR THE PURPOSES AUTHORIZED BY THE CONGRESS.

COMPETITION FOR GOVERNMENT BUSINESS FOSTERS EFFICIENCY, ECONOMY, AND INCREASED PRODUCTIVITY IN THE FEDERAL GOVERNMENT. THE DEFENSE DEPARTMENT'S EXPERIENCE IN THE LAST THREE YEARS OF VIGOROUSLY IMPLEMENTING A-76 PROVES THE CASE. A TOTAL OF 440 COST STUDIES WERE CONDUCTED BY THE THREE MILITARY SERVICES. SIXTY PERCENT -- OR 264 -- OF THESE STUDIES INVOLVING 11,000 FULL-TIME JOBS RESULTED IN A DECISION TO CONVERT TO PRIVATE SECTOR CONTRACTORS. THE SAVINGS ARE PROJECTED TO BE $90 MILLION ANNUALLY. FURTHER, A RECENT GAO REPORT ON GSA'S CLEANING COSTS FOUND THAT THEIR IN-HOUSE COSTS ARE NEEDLESSLY HIGHER THAN THE PRIVATE SECTOR. THE GAO ESTIMATED THAT IN FOUR REGIONS STUDIED, GSA COULD HAVE SAVED APPROXIMATELY $16 MILLION DURING 1980 HAD IT CONTRACTED FOR CLEANING BEING DONE BY ITS OWN CUSTODIANS.

WE ESTIMATE THAT THE GOVERNMENT CURRENTLY OPERATES THOUSANDS OF COMMERCIAL OR INDUSTRIAL ACTIVITIES WITH AN ANNUAL OPERATING

COST IN EXCESS OF $20 BILLION AND WITH A SIMILAR AMOUNT OF CAPITAL INVESTMENT. THE VAST MAJORITY OF THESE ACTIVITIES HAS NEVER BEEN SUBJECT TO COMPETITION. IF THESE ACTIVITIES WERE SUBJECT TO THE COST COMPARISON STUDIES REQUIRED BY A-76, WE ESTIMATE THAT 154,000 PERSONNEL SPACES COULD BE CONVERTED TO CONTRACT OPERATIONS WITH A 5-YEAR CUMULATIVE SAVINGS BETWEEN FY 1982 AND 1987 IN EXCESS OF $3 BILLION. THESE SAVINGS WILL CONTINUE TO ACCRUE THEREAFTER.

THE POTENTIAL FOR SUCH SAVINGS HAS BEEN RECOGNIZED FOR A LONG TIME. SINCE 1955, EACH ADMINISTRATION HAS EXPRESSED A GENERAL POLICY OF RELIANCE ON THE PRIVATE SECTOR FOR SERVICES NEEDED TO SUPPORT THE ACCOMPLISHMENT OF AGENCY MISSIONS. THE MOST RECENT EXPRESSION OF THIS POLICY WAS PUBLISHED IN 1979.

THE REAGAN ADMINISTRATION STRONGLY SUPPORTS THE GENERAL POLICY OF RELIANCE ON COMPETITIVE PRIVATE ENTERPRISE, AND HAS VIGOROUSLY EMBRACED IT AS EVIDENCED BY THE FOLLOWING ACTIONS:

- THE PRESIDENT AFFIRMED HIS SUPPORT OF THIS PROGRAM IN THE MARCH 1982 BUDGET REVISION WHICH STATED "IT IS THE GENERAL POLICY OF THE ADMINISTRATION TO RELY, WHENEVER POSSIBLE, ON THE COMPETITIVE PRIVATE SECTOR... OFPP IS, THEREFORE, WORKING WITH AGENCIES TO...-- INCREASE AGENCY COMPLIANCE WITH OMB CIRCULAR NO. A-76.

- A MEMORANDUM AND A SERIES OF LETTERS WERE SENT TO ALL EXECUTIVE AGENCIES AND DEPARTMENTS IN APRIL 1981

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REAFFIRMING THE POLICY AND REQUIRING IT BE VIGOROUSLY IMPLEMENTED;

- AN OMB BULLETIN WAS SENT TO ALL EXECUTIVE AGENCIES AND DEPARTMENTS REQUIRING THEM TO SUBMIT DETAILED INFORMATION ON THEIR IMPLEMENTATION OF THE PROGRAM AND ITS IMPACT ON THEIR FUTURE BUDGET SUBMISSIONS; AND

- IN JUNE OF THIS YEAR, CIRCULAR NO. A-11 WAS REVISED FURTHER TO STRENGTHEN LINKAGES BETWEEN BUDGET SUBMISSIONS AND AGENCIES' OVERALL IMPLEMENTATION OF CIRCULAR NO. A-76.

WE WOULD WELCOME A CLEAR STATEMENT OF INTENT BY THE CONGRESS IN SUPPORT OF THE POLICY THAT THE GOVERNMENT SHOULD NOT COMPETE WITH THE PRIVATE SECTOR. THE A-76 POLICY HAS BEEN APPLIED UNEVENLY OVER SEVERAL ADMINISTRATIONS, AND IT IS NOW TIME TO MAKE IT WORK. WE BELIEVE THAT PROPOSED SENATE JOINT RESOLUTION 93, INTRODUCED BY SENATOR HAYAKAWA ON JUNE 22, 1981, IS AN EXCELLENT MEANS TO CLARIFY AND REAFFIRM THIS AS A NATIONAL POLICY. IT WILL ILLUSTRATE TO THE PUBLIC AND PRIVATE SECTORS ALIKE THAT IT IS TRULY THE GOVERNMENT'S POLICY TO RELY ON THE PRIVATE SECTOR FOR FUNCTIONS THAT ARE NOT INHERENTLY GOVERNMENTAL.

THERE ARE THREE FUNDAMENTAL FEATURES OF THE CURRENT POLICY:

1. IT RECOGNIZES THAT EFFICIENCY IN GOVERNMENT OPERATIONS IS ONE OF THE ADMINISTRATION'S PRIMARY OBLIGATIONS TO THE AMERICAN TAXPAYER.

2. IT REQUIRES THAT COST ANALYSIS BE CONDUCTED TO DETERMINE IF AN EXISTING IN-HOUSE ACTIVITY SHOULD BE CONVERTED TO A PRIVATE SECTOR VENDOR OPERATION.

3. IT REQUIRES THAT THE COST ANALYSES BE COMPREHENSIVE, CONSISTENT, AND EQUITABLE BY PRESCRIBING USE OF A DETAILED COST COMPARISON HANDBOOK.

OUR OBLIGATION TO ACHIEVE EFFICIENCY IS ADDRESSED BY FOUR INSTRUCTIONS CONTAINED IN A-76. THESE INSTRUCTIONS INVOLVE:

1. REQUIRING THAT WHEN A CONTRACT FOR SERVICES EXPIRES IT MUST BE REVIEWED TO DETERMINE IF IT IS STILL COST EFFECTIVE.

2. REQUIRING AGENCIES TO MAKE COMPLETE INFORMATION AVAILABLE TO ALL INTERESTED PARTIES. DATA SUCH AS INVENTORIES, REVIEW SCHEDULES, AND RESULTS OF REVIEWS IS MADE AVAILABLE TO ALL INTERSTED PARTIES, INCLUDING AFFECTED GOVERNMENT EMPLOYEES AND GOVERNMENT UNIONS.

3. INSTRUCTING EACH AGENCY TO ESTABLISH A PROCEDURE FOR REVIEW OF ALL APPEALS SUBMITTED BY AFFECTED PARTIES. THE PROCEDURE MUST PROVIDE FOR AN EXPEDITIOUS RULING BY AN OFFICIAL OF EQUAL OR HIGHER LEVEL THAN THE OFFICIAL APPROVING THE ORIGINAL DECISION.

4. ENCOURAGING AGENCIES TO REORGANIZE IN-HOUSE ACTIVITIES FOR MAXIMUM EFFICIENCY PRIOR TO MAKING A COST COMPARISON WITH THE PROPOSED CONTRACT PERFORMANCE.

IN ADDITION TO OUR OBLIGATION FOR EFFICIENCY, WE RECOGNIZE THE NEED TO TREAT FEDERAL EMPLOYEES EQUITABLY. A-76 PROVIDES THAT EACH CONTRACT AWARDED FOR WORK PREVIOUSLY PERFORMED IN-HOUSE TO INCLUDE A CLAUSE GIVING DISPLACED GOVERNMENT EMPLOYEES A RIGHT OF FIRST REFUSAL OF EMPLOYMENT WITH THE CONTRACTOR FOR POSITIONS IN WHICH THEY ARE QUALIFIED.

THE CIRCULAR FURTHER RECOGNIZES IN ITS IMPLEMENTATION THOSE FEDERAL LAWS AND POLICIES WHICH DIRECTLY IMPACT IT. SPECIFICALLY:

- ALL PRIVATE SECTOR SERVICE CONTRACT EMPLOYEES MUST BE PAID AT LEAST THE WAGES AND FRINGE BENEFITS PREVAILING FOR SIMILAR WORK IN THE LOCALITY, AS DETERMINED BY THE DEPARTMENT OF LABOR.

- EMPLOYMENT PREFERENCE MUST BE GIVEN UNDER PRIVATE SECTOR CONTRACTS TO DISADVANTAGED PERSONS AND VETERANS, COMPARABLE TO REQUIREMENTS FOR FEDERAL EMPLOYMENT.

THESE ARE THE MAIN FEATURES OF THE POLICY AS IT IS CURRENTLY WRITTEN AND BEING IMPLEMENTED BY THE AGENCIES.

WE RECOGNIZE THAT THE IMPLEMENTATION OF THE POLICY AS IT IS PRESENTLY WRITTEN, WHICH REQUIRES THAT COST COMPARISONS BE CONDUCTED TO DETERMINE IF ANY ACTIVITY SHOULD BE CONTINUED IN-HOUSE OR CONVERTED TO A CONTRACT OPERATION, MAY BE VIEWED BY THE PRIVATE SECTOR AS CUMBERSOME AND PERHAPS INEFFICIENT.

BECAUSE WE HAVE RECENTLY FOUND SOME INEQUITIES AND CUMBERSOME PROCEDURES IN COST STUDIES, THE OFFICE OF MANAGEMENT AND BUDGET IS BEGINNING A REEXAMINATION OF THE CURRENT COST COMPARISON METHODOLOGY TO STREAMLINE IT AND MAKE IT AS EFFICIENT AS POSSIBLE.

SOME AREAS THAT WILL BE EXAMINED ARE:

- ESTABLISHING A POLICY THAT ALL "NEW STARTS," UNLESS THEY ARE INHERENTLY GOVERNMENTAL, WILL BE PERFORMED BY THE PRIVATE SECTOR.

- STREAMLINING THE COST COMPARISON PROCESS FOR ACTIVITIES UNDER $1 MILLION;

- RAISING THE CURRENT $100,000 THRESHOLD AT WHICH COST STUDIES MUST BE CONDUCTED TO RECOGNIZE INFLATION;

- REEXAMINING STANDARD COST FACTORS USED AND THE POSSIBLE ADDITION OF NEW ONES IN SUCH AREAS AS OVERHEAD RATES; AND

- REEXAMINING THE PRESENT COST DIFFERENTIALS WHICH GIVE PREFERENCE TO CONTINUATION OF IN-HOUSE ACTIVITIES.

- REEVALUATING THE COST FIGURES FOR GOVERNMENT EMPLOYEE BENEFITS.

IN THE INTERIM, IN ADDITION TO THESE, WE WILL BE ISSUING AN IMMEDIATE CHANGE TO THE CIRCULAR COVERING THE FOLLOWING AREAS:

- A STANDARD METHODOLOGY FOR DEVELOPING A PERFORMANCE ORIENTED DESCRIPTION OF THE GOVERNMENT'S REQUIREMENTS, RATHER THAN A DETAILED DESCRIPTION, WILL BE PUBLISHED AS A SUPPLEMENT TO THE CIRCULAR.

- METHODOLOGY CHANGES WILL BE MADE TO THE COST COMPARISON PROCEDURES IN SUCH AREAS AS:

  - DELETING THE REQUIREMENT THAT THE GOVERNMENT ALWAYS CALCULATE MATERIAL, FACILITY, AND EQUIPMENT COSTS EVEN WHEN THOSE COSTS WILL BE EXACTLY THE SAME FOR THE GOVERNMENT AND THE CONTRACTOR.

  - STREAMLINING THE COMPUTATION OF UNDERUTILIZED GOVERNMENT CAPACITY.

  - DEVELOPING NEW GUIDELINES FOR COMPUTATION OF ONE-TIME CONVERSION COSTS RELATED TO PERSONNEL (E.G., SEVERANCE PAY).

- DEVELOPING GUIDELINES TO STREAMLINE THE EFFORT FOR COMPUTATION OF DETAILED COSTS.

THESE ARE THE HIGHLIGHTS OF THE CHANGES THAT WILL BE FORTHCOMING IN THE NEAR FUTURE.

IN SUMMARY, LET ME STATE THAT THIS ADMINISTRATION FULLY SUPPORTS THE COMPETITIVE FREE ENTERPRISE SYSTEM. SMALL BUSINESSES, IN PARTICULAR, PROVIDE THE SPARK WHICH ENHANCES COMPETITION AND, THEREFORE, MAKES THE MOST EFFICIENT USE OF OUR NATION'S RESOURCES. IN NO REAL SENSE IS THE GOVERNMENT A COMPETITOR -- IT IS AN ARBITRATOR OF ECONOMIC DECISION WHEN IT "COMPETES" WITH SMALL OR LARGE BUSINESS.

THUS, WE NEED A STRONG A-76 PROGRAM AND WE NEED A STRONG REAFFIRMATION OF A POLICY OF RELYING ON THE PRIVATE SECTOR FOR GOODS AND SERVICES FROM THE CONGRESS. THE KIND OF REAFFIRMATION OF THIS RESOLUTION WHICH WE FIND IN PROPOSAL S. J. RESOLUTION 93 IS EXACTLY WHAT WE NEED AT THIS TIME.

THE ADMINISTRATION WELCOMES A CLEAR AND VIGOROUS REAFFIRMATION OF THE FREE ENTERPRISE SYSTEM THAT HAS MADE THIS COUNTRY STRONG. WE BELIEVE IT PROVIDES TIMELY SUPPORT FOR THIS ADMINISTRATION'S QUEST FOR A NEW, REVITALIZED APPROACH TO STRENGTHENING THIS COUNTRY'S ECONOMY. ECONOMY AND EFFICIENCY IN GOVERNMENT AND REWARD OF THE PRIVATE SECTOR FOR INITIATIVE AND PRODUCTIVITY ARE NECESSARY INGREDIENTS IN OUR FORMULA FOR ECONOMIC RENEWAL.

MR. CHAIRMAN, I HOPE THAT MY COMMENTS HAVE BEEN USEFUL IN EXPLAINING THE ADMINISTRATION'S POSITION ON CONTRACTING OUT AND THE PROMISE IT HOLDS FOR MORE EFFECTIVE GOVERNMENT.

I WILL BE PLEASED TO ANSWER ANY QUESTIONS YOU MAY HAVE.

Senator **Jepsen**. I would yield and ask Congressman Reuss for any comments or questions he may have.

Representative **Reuss**. Thank you very much, Mr. Chairman.

Mr. Stockman, I find myself fully in accord with your testimony that small business is a vital national resource which we must protect from mindless Government intervention.

As I say, I completely agree. Let me discuss with you a case history and then I'll ask for your comments. Small business bankruptcies are increasing alarmingly, some 13,000 of them so far this year, up 45 percent from last year; and one of the principal causes, in my judgment, is the cruelly high level of interest rates. High interest rates are caused by the interaction of the supply and demand for money. The demand for money and supply of money as provided by the Federal Reserve has been very, very meager this year indeed, and one of the reasons for that is the famous "Dunkirk" memorandum which you issued last December in which you said:

> President Reagan should meet with Volcker at an early date and issue a new informal charter, namely to eschew all considerations of extraneous variables by short-term interest rates, housing market conditions, etc.

President Reagan took that advice and did issue marching orders to the Fed which have been followed and which have resulted, as I say, in extremely tight money—M_1B, fourth quarter 1980 to second quarter 1981, at the rate of 2.2 percent. At the same time that monetary policy has been extremely tight, fiscal policy has been loose, as evidenced by the swamping of the civilian spending cuts by the increase in military spending and by tax reductions.

You were quoted, Director Stockman, in the paper this morning as insisting "that the administration is not making a fetish out of a balanced budget by 1984," and it goes on to say that you "observe that high interest rates and continued spending pressures may make balance impossible. The fiscal balance objective as symbolized by closing the deficit to zero by 1984 is now seriously behind schedule for a hundred little reasons and no one particular fault." You were said to have said, "The objective is to bring the revenue path and the spending path under an expanding economy into balance out there in the 1984 range."

Well, however you slice it, if we don't balance the budget in 1982 and don't balance it in 1983—and now it appears that we aren't going to balance it in 1984—then the Treasury will stay in there heavily on the demand side bidding up the price of money, with the net result being tight money. And heavy Treasury bidding is pure misery for small business as well as for many others.

Isn't this a piece of mindless governmental intervention and shouldn't we go back and do it over?

Mr. **Stockman**. Well, Congressman Reuss, with a very strong qualification, let me say that your description is probably accurate. Let me also point out that I agree that the interest rate is a function of supply and demand for money.

I don't agree that the supply of money has been too stringent over the past year or past several years. In fact, the reason that our economy is inflicted with the inflationary disorder today is that the supply of money has been excessive and chronically excessive for years and years and years.

The problem is on the demand side of the ledger. The problem is that in the fiscal year that just closed 20 days ago we borrowed nearly $80 billion and that $80 billion borrowing requirement for on-and-off budget activities was the second year in a row of unprecedented borrowing of that magnitude.

I would point out to you that even though you had a point to make about defense and the tax cut, that neither the defense buildup nor the tax cut affected the level of borrowings in 1980 nor 1981. We won't really see the effect on the budget in terms of outlays—therefore deficit of borrowing requirements—of the defense buildup until 1983 and 1984 when those numbers move well above their range.

The tax cut, Mr. Chairman, took effect October 1. It was 1.25 percent of personal income tax liabilities. That won't even be reflected for the most part until next spring when people get their refunds.

Now I do recognize, therefore, that the current crisis is simply a reflection of the excesses of the past and the fiscal imbalance that we inherited. But I do agree that prospectively in the future we will have a serious problem, next year or the year after, unless we make determined and effective headway in reducing the deficit from the past that we have outlined, and I think we are now at the point where Congress is going to have to consider some very tough and very serious action in order to bring that deficit down.

If we don't bring it down, your characterization will continue to be accurate, but I'm confident that we will bring it down because everything that we're trying to accomplish with this economic policy requires achieving a balanced budget or fiscal balance and removing that enormous Treasury pressure on the demand side of the market.

Representative Reuss. The rate of M_1B growth, as I've said, is slightly over 2 percent at present. Under the directions to the Fed given by President Reagan in his February 18, 1981, economic recovery program, the Federal Reserve is supposed to lower its targets further this January 1.

Do you think in view of the fact that inflation is currently running at a rate of 14.8 percent annualized and in view of the fact that interest rates over a year ago are up hugely, that it is wise at this time to tighten money even more on January 1 and thereafter than we're tightening it now? Isn't that mindless intervention?

Mr. Stockman. Well, no, I wouldn't characterize it that way at all, and before answering directly your question, I think we have to get a few of our numbers straight in order to establish the proper context.

No. 1, yes, in the last several months M_1B has been coming in at a very low rate. It seems to me, especially to you, who have been one of the great experts in Congress for many, many years, recognize that with the enormous change and innovation occurring in the financial markets today that a measure of one money variable, of M_1B, especially being affected by changes in financial deposit practices for only a few weeks or a few months doesn't really tell the whole story.

If you assume that M_1B is still a valid measure of what we would call transaction deposits in the economy, I would at least suggest that we look at a year or at least the last 9 or 10 months. In that case, the growth rate has been about 5 percent which is geared to the target, and I think not unduly low.

The second point I would make is that taking an alternative money variable, M_2, which must be considered now because it includes the money funds which have become more and more transaction deposits, that has been increasing at the top end of the target range, at about 9 percent over the last year.

The third clarification on the numbers is the inflation rate, as you well know, is not 14 percent. That was a 1-month CPI annualized figure. It reflects the lagged effect of upward movement in the mortgage rate beginning in about May. I think if we look at any other more basic measure of inflation over the last 7 to 10 months you see a very clear, very decisive pattern of reduction. I could point out that in the third quarter the wholesale price index averaged less than 4-percent rate of increase and that over the last 9 or 10 months it's been coming in on a trend of 7 percent compared to nearly 14 percent last year.

So what we see is that rather than an excuse for changing the monetary policy, instead, the monetary policy is working. Inflation is coming down. The inflationary pressure is being squeezed out of the economy. If we want to reduce the burden of these currently prohibitive interest rates on small business and all other business for that matter, it seems to me what we ought to do is not quarrel with the monetary policy which is correct, but address the problem which we jointly are responsible for, and that is the fiscal policy, the budget, and the deficit, and work in every way we can devise to get that Treasury borrowing requirement reduced.

Representative REUSS. If you think monetary policy now is correct, why do you insist on tightening it on January 1, 2 months from now?

Mr. STOCKMAN. Because the policy we have outlined and I think the correct one is to steadily reduce the growth rate of the money supply over a 4- or 5-year period in order that eventually we will achieve a point of price stability and a monetary policy that is comparative with noninflationary growth. This is what the Fed has been attempting to do for the last 2 years and I don't believe that we should retreat now due to some very temporary difficult conditions in our economy. It's clear that in the long run, when all is said and done, excessive growth of money and credit is the cause of inflation and the most serious threat to the long-run health of our economy and to the financial viability of business, large and small, is inflation. It does not remain stable. It gets worse, unless it's attacked and corrected and reduced.

We are making enormous progress on that now and I would hope it wouldn't be jeopardized by short-sighted path on a disinflationary policy.

Representative REUSS. Well, my time is expiring. But I would just say that among these extraneous economic variables that you don't think should be considered are things like 1 million men and women jobless since last July, nor, as I have said, 13,000 bankruptcies—almost all of them small business, so far this year. Let us pray that you're right.

Thank you very much.

Senator **Jepsen**. Senator Symms.

Senator **Symms**. Thank you very much, Senator Jepsen.

David, have you had any input from the military on this as far as this A-76 on what this might do to the capability as far as our own independence? If they contract everything out to private contractors and then they go overseas, how does that impact just on the basic laundry items?

Mr. **Stockman**. Senator Symms, there's a very carefully designed policy there. Activities which are essential for national defense are exempted, and so although in a mechanical way we can calculate some $20 billion worth of activity at DOD every year that are in the descriptive category, commercial and industrial, about 80 percent of those are deemed not appropriate for A-76 cost review and possible contracting out. In other words, we have a specific and unique policy that applies to DOD and it's for the very reasons that you mentioned.

On the other hand, DOD has been a pioneer in contracting out those activities that do not have any deleterious effect on readiness military forms and capacity and other functional organizational requirements in the services, and because of that, as I indicated in my testimony, we are saving somewhere in the range of $100 million a year and will save a lot more as this process is pushed forward.

Senator **Symms**. Thank you. There's another area of government where we talk nowadays—the word is not tax increases, but revenue enhancement areas—and one of the revenue enhancements that's taking place starting the 1st of November is a 2-cent increase in the cost of the postage stamp to help fund the efforts of the Post Office.

I happen to be one that thinks that probably our Post Office gets a lot more criticism than maybe they deserve because when we lose a letter you either lose it getting it to the Post Office or you lose it getting it back home, so there are three places to lose the letter and they always hear about the ones that are lost.

But, nevertheless, when we talk about the area of competition, the Postal Service has the privilege of operating as a monopoly. I intend to introduce a bill next week, the first of the week, Monday, that would repeal the first-class statute that gives them that privilege of monopoly.

How would OMB view that with respect to the overall general competition? That would allow small business the opportunity, if it were passed into law, to carry letters. What would your viewpoint be on that aspect?

Mr. **Stockman**. Senator Symms, let me just state that at the present time we have launched a major study internally within the administration on the private express statutes and we haven't finished those studies yet. We haven't formed any conclusions, but when they are completed we will certainly provide the conclusions and information to you because of your strong interest in this area.

I believe we need to take a very hard look at it, perhaps not on an across-the-board basis, but there are certain types of mail where the introduction of competition would be helpful. We have seen that in the package and parcel business and it seems now what we ought to do is see whether that could be extended to other classes of mail.

But I would caution that the Post Office is a very valuable national asset, even though we all think it's inefficient and we all have our criticisms one way or another of it and so, in changing policy, if we should, after a thorough study, I believe we have to be very careful about phasing transition and so forth.

Senator SYMMS. I would agree with you, and even though I'm introducing this legislation, I would be the first to say it's always "compared to what" and if you add up the number of letters that they do deliver and get there on time I think it's incredible that they can do as well as they do. I do think, though, that they are operating without the privilege of competition which denies them innovation that might otherwise come about if there were people competing with them in the same field and same market, and I know Senator Jepsen has been very interested in the Postal Service and how it works and some of the new techniques that they are using and has made some very excellent explanations to the Senate on whether or not we should have a nine number ZIP code and so forth, and I have often thought that maybe the right answer was just to let somebody else compete with them and if they can operate better with seven numbers on the ZIP or nine or five or whatever, let them do it and not bog the system down with us trying to figure it out. So I hope that you will look into that and look into what the impacts might be.

The other area of competition that I wanted to ask you about—and I didn't want to get into the monetary policy but since Chairman Reuss has already brought it up, I might ask you—there's a great deal of talk nowadays about one way to balance the budget would be to call in all the bonds that we have and reissue gold-backed bonds at lower interest rates and it would reduce the national interest bill out of your budget by some $50 billion a year if interest rates could be lower on gold-backed bonds.

Another suggestion that some of us have suggested is that the Federal Reserve—what they really need is competition, and we have introduced a bill which would—I have introduced a bill in the Senate and I think Congressman Dan Crane introduced the same bill in the House—which would allow for a gold money system to compete with the Federal Reserve monopoly on our money supply so that if people are simply unhappy with the system that operates through the Federal Reserve that they could use gold coins issued by the Treasury to do business with and that would be a measure to give the Federal Reserve the opportunity to realize whether or not they are printing too much money or not enough money.

Does this come under the category of anything that OMB will be looking at as far as examining competitive systems for government? Because certainly the monopoly that the Federal Reserve has on the creation of money has been given to them by the Congress and it certainly would be an area where competition is lacking as far as the money system is concerned. Would you want to comment on that?

Mr. STOCKMAN. Well, I guess on the latter point, that proposal is under lively debate at the present time on the gold system and some of the participants happen to be in the room here today. So rather than reopen that debate which I think we had just a couple days ago, I would rather—I'm interested in what the conclusions and deliberations of the gold economics are on that, but I wouldn't have any firm view of its viability. Frankly, I think there are some rather serious problems with it.

On the more limited proposal of gold-backed bonds, a number of fairly respected and prominent economists with a lot of different theoretical persuasions suggest that that's something to be looked at. That is being reviewed by the administration. I don't think it's quite as simple as it sounds on the surface, but nevertheless, the interest charges that we are paying today will exceed $82 billion in fiscal 1982 and if there's some way to temporarily abate that level of cash flow costs to the Treasury it will help us reduce the outlay level and the deficit.

However, I would point out that you're simply shifting those payments in time and that sooner or later they are going to come due down the road rather than in the current period. An alternative way of doing it would be to simply issue discount bonds as some private sector firms are doing at the present time with a lower interest rate than the market and selling at a discount below face value. Again, the basic effect of that is to shift the due bill from 1987 to 1995 rather than paying interest in current installments.

But given the enormous fiscal squeeze and the unprecedented turnaround that we are trying to undertake in governmental finance and in national economic policy, some of those things could be looked at; but if they are relied on too heavily I'm afraid they might appear more to be gimmicks rather than efforts to address the basic problem, which is a set of expenditure commitments, entitlements and otherwise, which far exceed the revenue outlays that we have coming in now and will for the future. I don't think we can solve the problem with gold-backed bonds. I think we're going to solve the problem by debating the policy issues, the programs, the funding levels, and entitlements that are now driving the budget to these current levels.

Senator SYMMS. Thank you very much. Mr. Chairman, could I ask just one brief question and that is about A-76? In the competitiveness with Government for services, does it also cover having Government agencies just buy goods off the shelf as much as possible instead of always coming up with a new set of specifications for something which particularly fits a Government agency?

Mr. STOCKMAN. Well, I think it would bear on that but basically that would—the issue you're raising relates to procurement in the basic sense and, as you know, we have been charged with developing a new uniform procurement system. Those proposals will be coming forth to Congress shortly and I think they will be addressed in that instance.

Senator SYMMS. Well, I would like to encourage you to try to encourage the Government to stop coming up with a specific set of—they always come up with a certain set of specifics for the certain goods that the Government wants to buy. Everybody else goes out and buys it from the store or a wholesale distributor except the

Government, and they have to have something made a specific way, and I would think that we might make a great deal of savings for the taxpayers by simply buying off the shelf and I would hope that you would push that along with the competition and allow small business to have a bigger piece of the action.

Thank you very much, Mr. Chairman.

Senator JEPSEN. Thank you, Senator.

Mr. Director, there's been a serious criticism about the adequacy of present A-76 policy. For example, in the May 1981 issue of Government Executive, a member of the Commission on Government Procurement in the early 1970's and currently an official at GAO raised serious questions about the present requirement that in every case where the Government is considering contracting out an activity, a cost comparison must be performed even though highly competitive private sources exist to produce the goods or perform the service required.

Now is OMB considering any alternative which would reduce the paperwork and eliminate the unnecessary, time-consuming requirements now followed in connection with cost comparison?

Mr. STOCKMAN. Mr. Chairman, we are. I indicated in my testimony some of the steps that we are looking at that we have under review. Clearly, in the case of small dollar volume activities it would be desirable to eliminate the need to go through an entire cost comparison review and we would achieve that by raising the current $100,000 threshold. Similarly, we have proposed—or at least would look at simplifying the process for activities that are annual costs of less than $1 million. We also believe that it would facilitate the process, remove some of these barriers that you talk about—we could achieve that by establishing more standardized processes rather than to have to apply unique analysis and accounting operations to each activity that's under A-76 review. By creating more standard cost factors this process could be expedited rather substantially.

There are a variety of other things of that nature which we think could be done to reduce the burden and achieve the objective that you're speaking of here and we have those under advisement and review at the present time.

Senator JEPSEN. Mr. Director, many small business people who regularly pay taxes to the U.S. Government were shocked to learn that under the present A-76 a private commercial source is considered to include State and local governments and nonprofit organizations. How does the OMB justify this preference for non-taxpaying entities and what reforms do you propose in that area?

Mr. STOCKMAN. Mr. Chairman, when I found that out I was as shocked as you are and I'll look into that and see if the statutes ought to be changed.

Senator JEPSEN. Similarly, many small businesses are shocked to learn that 80 percent of what the Department of Defense does is exempted under the A-76 policy on the basis of national security. I'm all for national security, as I know you are, but are we taking a hard look at this? Are you undertaking a review?

Mr. STOCKMAN. Yes, we are, Mr. Chairman, and that 80-percent figure isn't fixed in stone by any means, but it is a very complex area. You have competing objectives of values to be balanced and weighed, but we will continuously and constantly review that issue to determine or to make sure that everything that can possibly be considered subject to A-76 review will be, making efforts to insure that important national security objectives or considerations are not jeopardized.

Senator **Jepsen**. There's been a great deal of talk and banter about Government functions which can only be performed by in-house personnel. I suspect a lot of that is generated by the bureaucracy itself here. Are you disturbed that the Government's access to highly specialized technical and professional skills is being arbitrarily limited by unnecessary broad definition of what is a function which only a Government worker can perform?

Mr. **Stockman**. Mr. Chairman, that is another one of the basic dilemmas that we have in this process. Clearly, there are some essential core governmental functions that ought to be performed by governmental employees, but in terms of precisely defining that there is never a final solution, a clear-cut answer, and I think my only assurance that I could give to you is that we constantly review it to make sure that it is as narrowly and tightly and specifically focused and defined as possible.

Senator **Jepsen**. I notice in your opening remarks that there were some areas in here that dealt with the obligation that you felt you had toward the Government employees. Now representatives of Federal employees have expressed concern about present Federal employees losing their jobs if the work is moved from in-house Government to a private sector organization. I have great mixed emotions about that. I want everybody to have a job and have a good one. But are we going to drag our feet in reorganizing and reforming some of this with the bureaucracy doing its normal "let's see how many road blocks we can throw in the way and confuse them and maybe they'll all get tired and leave us alone pretty soon and go back to business tomorrow?"

Mr. **Stockman**. Mr. Chairman, my answer to that would be unequivocally no. We have made a continuing and aggressive effort to monitor the activities of every agency to insure that they have the schedule of A-76 reviews that covers as many of their industrial and commercial activities as possible.

Now in terms of Federal employees, I would say that they are amply and well protected by the current system and, if anything, it is probably overly generous in their behalf. For instance, they have the right, as I indicated, to appeal decisions to contract out. As I indicated, they have the right of first refusal, if an activity is moved from an in-house basis to a contract basis, to be employed with the successor employer or contractor involved. They have the right of grade retention and pay retention for 2 years if they are transferred to other governmental positions as a result of one of these decisions, and you can go on down the line on the service contract coverage and so forth. And it seems to me that it's a pretty well protected system from the governmental employees' point of view.

Senator **Jepsen**. Now out of curiosity, getting back to the area where you say they have the right to have first refusal or first choice at being employed by some company that may take over this work——

Mr. **Stockman**. If they are qualified.

Senator **Jepsen**. Mechanically, how does that work? Let's say someone in private business comes in my office and says they can do something better and faster and more efficiently and more economically than what's done. Is there going to have to be the same kind of review process about taking some of those folks in the affected agency? Does the private business have an agreement with the contractor or does he have to acquiesce to hiring some of these folks before he does business?

Mr. **Stockman**. That would generally be written in the contract.

Senator **Jepsen**. It's not easy to untangle these things, is it?

Mr. **Stockman**. No, it isn't.

Senator **Jepsen**. Congressman Reuss.

Representative **Reuss**. Thank you. I think the Director has a 10 a.m. obligation and I had a fair opportunity, so I thank him and you.

Senator **Jepsen**. It is 10 a.m. and thank you very much, Director Stockman, for spending the hour with us and I also thank you for the work that you're doing there. I know where your heart is and you have unlimited talent and ability. We respect that, and you have a tough task I know.

Mr. **Stockman**. Thank you.

Senator **Jepsen**. I would invite Mr. Collison, president of the Iowa Small Business Employers, Inc., to come forward. I'd like to welcome you, Jim. It's always good to see someone from my own State, a State, surprising to a lot of people in this country, that ranks in the top 10 for exports. Most people think just because we're No. 1 in farm and soybeans and pork production that all we have is an agricultural economy. We have a twin empire State of agriculture and industry. One community, Cedar Rapids, is, per capita, the single largest exporter in the United States of America. So even though we're landlocked and in dead center of the United States, we've got a lot of interest in all areas and small business ranks supreme. I want to thank you for your interest and all the time and work you're giving to this. I welcome you to this committee and welcome you to Washington. You may proceed.

STATEMENT OF JIM COLLISON, PRESIDENT, IOWA SMALL BUSINESS EMPLOYERS, INC., MASON CITY, IOWA

Mr. **Collison**. Thank you very much. We thank all of you for this opportunity to express our concerns about the ways in which governments at all levels compete with profitmaking businesses, particularly small business.

The Iowa Small Business Employers, Inc., headquartered in Mason City, Iowa, organized in early 1978 to provide legislative lobbying, educational, and benefit services to members. We are now the largest business organization in the State with nearly 2,500 members. Our average member has 7 employees. We speak for the typical business in Iowa, which is very similar in size and structure to the typical business in the United States. Of the more than 60,000 businesses in Iowa, nearly 90 percent have 20 or fewer employees. More than 78 percent have 10 or fewer employees.

To stay within my time limits, I will present excerpts from my prepared statement which I have submitted for the record.

I will begin with my personal experience. I have been a small business person for nearly 20 years. For most of those 20 years I was a sole proprietor, selling educational and business consulting services. As a small business person I soon learned that my greatest competitors were Federal, State, and local government-financed agencies and personnel.

In the late 1960's and 1970's we were associated, as reading consultants, with Integrative Learning Systems, Inc., a small firm located in Glendale, Calif., and operated by the husband-and-wife team, Ted and Colleen Vail. The Vails, in the 1960's developed a highly successful reading program.

You will recall the Federal Government's Right to Read Program poured millions of dollars into the educational system to encourage the development of successful reading programs. The Right to Read Office funded a nationwide search to locate the most successful reading programs in America. Programs designed by the Vails, in three schools, were selected in this search as 3 of the top 25 new reading programs. The Right to Read Office then selected 12 programs from among those 25 and prepared dissemination materials about them to distribute to schools throughout the Nation to encourage their replication. Not one of the Vail's three programs was chosen by the Right to Read Office for dissemination and replication. When we inquired as to why a Vail program was not considered for dissemination, we received a telling reply.

The letter came from Edward B. Glassman, then in the Office of Planning, Budgeting, and Evaluation, in the Office of Education, dated May 1, 1975, and concluded:

> I should mention also that the DRP—Dissemination review panel—has so far abstained from approving for dissemination any program of a proprietary nature pending clarification of the legal constraints on OE in this sensitive area.

In other words, "Since your company is a business corporation, get lost."

A major area of the use of the taxpayers' money to compete with private business is in the related area of educational printing. I cite an example from my own experience. It has not been uncommon for us to learn that schools use tax funds to make unauthorized publishing runs. So I was not surprised when visiting an agency in Wisconsin which had been using our program for 2 years, I found the agency had made copies of our student manual, on its copier, for all students. I asked the director of the program about this and he explained, with no embarrassment, that they had run out of money in their educational materials fund and could not send through a purchase order for the books. However, they discovered an excess in their budget for the copier, and therefore ran off copies of our student book. This agency received more than 50 percent of its budget from Federal grants.

To prepare for this testimony I sent a questionnaire to 63 of our members who serve on our board of advisers. Only 15 of the 63 business people surveyed indicated that government competition affects their businesses. Since my sampling was not scientific, I would guess the 25-percent positive response is not representative of the small business community as a whole. I would guess the number of businesses experiencing direct competition from governments at all levels would be no more than 5 to 10 percent of the total.

The greatest single area of government activity which competes with small business, which I have found, is in the printing business. Every printer I contacted in Iowa complained about competition from government bodies, particularly from educational agencies. I will give an example of government competition in the area of printing.

The Post Office imprints and sells envelopes, for the price of the postage, plus a very small charge for the envelope and the imprinting. For example, the Post Office will sell 500, No. 10 business-size envelopes—with postage imprinted—for $6.85 over the cost of the postage. A business supply store, in Mason City must charge $8.70 for similar plain envelopes. The Post Office will imprint these 500 business envelopes, at a charge of $9.85 over the cost of the postage. A printer in Mason City must charge $19.95 for the same job.

Here are additional examples of how taxpayer money is used to compete with taxpaying businesses.

A small town printer wrote this comment to me:

> Our local ASCS—Agricultural Stabilization and Conservation Service—office prints as a service to beef producers, pork producers, and other organizations all of their dinner, pancake feed, soup suppers, et cetera, tickets plus any literature they might need, at no charge. It seems that since printers pay taxes to support our government office, that the printers should be able to print the in-house printing that is done in these offices. There is no way that I can estimate the financial loss to my shop alone.

A custodial business in an Iowa community of 25,000 population reports losing about $75,000 gross per year from work lost to government agencies. The owner of this business states, "Governments almost always provide their own custodial staffs. There is never a chance for small outsiders to bid on these jobs."

Job Service competes with private job placement businesses in recruiting and finding new jobs for persons already employed. Many employers wonder why Job Service has gotten into the business of raiding persons already working for them. As one employer stated it:

> Iowa Job Service has called up people after we have hired them and offered them other jobs under VA training programs even though they knew that we had just hired them.

The FmHA Director in Iowa from 1980–81, Richard E. Myers, is a member of our Board of Advisers and sent me the following statement to include in this testimony:

> I think the government should get out of the direct loan business to agriculture. The only exceptions might be natural disasters such as hail or drought.
>
> The current direct loan programs should be changed to a guaranteed loan program such as the Small Business Administration runs. This would have two effects. It would keep the small farm banks and the farmers tied together so the farmers would not stay in the program forever. The bank would service the loan because it has a stake in it and therefore require less of a bureaucracy to administer the program.
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> To demonstrate my concern, according to the Federal Reserve in February 1981, 48 percent of the total agriculture debt in the country is being carried by the Federal Government through agencies such as FmHA, ASCS, Federal Land Bank, and the

> Production Credit Association. In FmHA alone, this figure has increased from 9 percent of total debt to 16 percent in just the last four years.
>
> Of course, the banks are partly at fault. Because of current money market conditions, they are pushing the farmers toward the Federal Government as fast as they can. Also the bureaucracy of the USDA would fight this idea with all their resources. Why? Because they do not want to lessen their influence or control on any facet of any program. But I believe the Congress should hold their—the bankers and USDA—proverbial feet to the fire.
>
> Finally, the best thing of all is that the direct loan dollar is an appropriated Treasury dollar while the guaranteed dollar is a local banker's dollar and therefore, I think, less inflationary. This government program has caused the banks to abdicate their lending reponsibilities to the Federal Government, and has given the USDA too much credit responsibility in what should be a private enterprise area.
>
> During the period I was administrator, I felt sincerely that one-fourth of my program could have been eliminated.

I have cited numerous examples of direct competition by government with business. The worst competition by government with business, however, is indirect. It affects every person and every business in the country. This is the Federal Government's competition for dollars.

One of the clearest statements of this reality was made on September 14, 1981, on the MacNeil-Lehrer report by David Jones, an economist in the bond and money markets with the investment firm of Aubrey G. Lanston & Co. Mr. Jones stated:

> There is not much new money to go around, and if the Federal Government comes in—elbows its way into the market—very few borrowers are going to have anything left over—state and local governments, mortgage borrowers, and most importantly, small businesses will have nothing left.

The letters and telephone calls I receive from small business employers tell me that people at the grassroots are angry. Your mail and your phone calls must be telling you the same. You must be hearing comments just like this one from a southern Iowa farm implement dealer:

> Our company was founded over 20 years ago by the original owner whom we bought out in 1972. Since that time, we have shown a steady growth until the first onset of 20 percent rates in 1980. Currently, our net sales at this time are barely 40 percent of our 1979 rate. It does not take a genius to determine that we are now fighting for survival, as are most other small businessmen. We were able to progress with inflation, but if we can't have some relief soon, our company could become extinct.
>
> Currently, I have seen prices increase on farm tractors three times since January 1, 1981, and each increase averages from 4 percent to 8 percent. How can this result in a lowering of inflation? The plain fact is that the Fed's policy is not working now, and commonsense tells us that it never will. It will be slight consolation to those businessmen who are forced into bankruptcy to hear a year or so from now that Paul Volcker is sorry but he thought it would work.
>
> I fully realize that my observations border on the ridiculous, because it is simplistic to believe that any of the above will have any impact on anyone in a position of power. But at least I have had the satisfaction of saying something to someone.

Of all the instances of government competition with small business that I have mentioned, the most damaging to all small businesses is government's competition for capital. Every other effort by the Congress to stimulate and promote the small business sector will result in failure, until government competition for capital is ended.

The small business economy is nearing a depression. Many small businesses in the past 18 months have gone bankrupt. Even more may go bankrupt in the next 12 months. The damage being done now by government's competition for capital will take years to mend. The longer you in the Congress permit this competition to continue, the greater will be the human tragedy—the depressed towns, the bankrupt employers, and the workers thrown out on the junkheap of unemployment.

And this concludes my remarks, Mr. Chairman.

Senator **Jepsen**. Thank you, Mr. Collison, your prepared statement will be printed in the hearing record. Your testimony is very timely and you're telling it like it is.

[The prepared statement of Mr. Collison follows:]

PREPARED STATEMENT OF JIM COLLISON

Government Competition with Small Business

We thank you for this opportunity to appear before the Joint Economic Committee of the United States Congress to express our concerns about the ways in which governments at all levels compete with profit-making businesses, particularly small businesses.

The Iowa Small Business Employers, Inc., headquartered in Mason City, Iowa, organized in early 1978 to provide legislative lobbying, educational, and benefit services to members. We are now the largest business organization in the state, with nearly 2,500 members. Our average member has 7 employees. We speak for the typical business in Iowa, which is very similar in size and structure to the typical business in the United States. Of the more than 60,000 businesses in Iowa, nearly 90% have 20 or fewer employees. More than 78% have 10 or fewer employees.

Direct government competition with small business does not have a major impact economically on the small business economy. However, in preparing for this testimony, I have been impressed with instances of direct government competition with small business that we normally do not think of. I am led to conclude that if we were to search a bit longer and a bit more thoroughly we might uncover greater involvement by government at all levels in a variety of competitive endeavors in the business economy.

I will begin with my personal experience. I have been a small business person for nearly 20 years. For most of those 20 years I was a sole-proprietor, selling educational and business consulting services. As a small business person I soon learned that my greatest competitors were federal, state and local government-financed agencies and personnel.

In the late 1960s and 1970s we were associated, as reading consultants, with Integrative Learning Systems, Inc. (I.L.S.), a small firm located in Glendale, Ca., and operated by the husband-and-wife team, Ted and Colleen Vail. The Vails, in the 1960s, developed a highly successful reading program.

You will recall the federal government's Right to Read Program poured millions of dollars into the educational system to encourage the development of successful reading programs. The Right to Read Office funded a nationwide search to locate the most successful reading programs in America. Programs designed by the Vails, in three schools, were selected in this search as three of the top 25 new reading programs. The Right to Read Office then selected 12 programs from among those 25 and prepared dissemination materials about them to distribute to schools throughout the nation to encourage their replication. Not one of the Vails' three programs was chosen by the Right to Read Office for dissemination and replication. When we inquired as to why a Vail program was not considered for dissemination, we received a telling reply.

The letter came from Edward B. Glassman, in the Office of Planning, Budgeting and Evaluation, in the Office of Education (dated May 1, 1975) and concluded:

> "I should mention also that the DRP (Dissemination Review Panel) has so far abstained from approving for dissemination any program of a proprietary nature,pending clarification of the legal constraints on OE in this sensitive area."

In other words, "Since your company is a business corporation, get lost!". Imagine this: A federal agency--supported by tax dollars generated by our free enterprise, profit-making system--says it can't disseminate information on a proven program, discovered and varified by a search it financed, because that program is a private, profit-making venture. I've often wondered how many hundreds of thousands of people can't read well today because bureaucrats in Washington freeze out proven, successful, low-cost programs simply because we who design such programs have the courage to function as private, free enterprise, small businesses.

A major area of the use of the taxpayers' money to compete with private business is in the related area of educational printing. I cite two examples from my experience.

A school district in Wisconsin had purchased our reading program and my consulting services. One day I received a telephone call from the administrator of the program in the school district, requesting permission to make copies of our teacher manual on their copier. Needless to say, I denied permission. However, it has not been uncommon for us to learn that schools use tax funds to make unauthorized publishing runs. So I was not surprised when, about a year later, on visiting another agency in Wisconsin which had been using our program for two years, I found the agency had made copies of our student manual, on its copier, for all students. I asked the director of the program about this, and he explained, with no embarrassment, that they had run out of money in their educational materials fund and could not send through a purchase order for the books. However, they discovered an excess in their budget for the copier, and therefore ran off copies of our student book. This agency received more than 50% of its budget from federal grants.

To prepare for this testimony I sent a questionnaire to 63 of our members who serve on our Board of Advisors. I wanted to get a feeling about how widespread is government competition with the business community, and which types of businesses are affected most.

I don't want to exaggerate the problem. Only 15 of the 63 business people surveyed indicated that government competition affects their businesses. Since my sampling was not scientific, I would guess the 25% positive response is not representative of the small business community as a whole. I would guess the number of businesses experiencing direct competition from governments at all levels would be no more than 5% to 10% of the total.

The greatest single area of government activity which competes with small business, which I have found, is in the printing business. Governments at all levels compete with printers. Every printer I contacted in Iowa complained about competition from government bodies, particularly from educational agencies. I will present two examples.

One day my son, a high school student, brought home a large notebook containing more than 200 pages. It was his text for a course he was taking. This book was written by the instructor (paid by taxpayers), and the book was printed with taxpayer money. I can not believe that the taxpayers saved money by paying one individual (hired to teach) to write and edit this publication, by paying a typist to set it up, and by paying to have it printed. It certainly would be less expensive to purchase books from one of the many publishers who publish suitable books on all subjects.

Furthermore, this taxpayer-financed publication, even if justified, is a classic example of how a government project wastes money, compared to a similar project done by private business. This book originally was printed on only one side of each page. In other words, 50% of the pages were blank. In the current edition, 12% of the pages are blank.

A second example of government competing with the printing business is found in every U.S. Post Office in the country. The Post Office imprints and sells envelopes, for the price of the postage, plus a very small charge for the envelope and the imprinting. For example, the Post Office will sell 500, #10 business-size envelopes (with postage imprinted) for $6.85 over the cost of the postage. A business supply store in Mason City must charge $8.70 for similar plain envelopes. The Post Office will imprint these 500 business envelopes, at a charge of $9.85 over the cost of the postage. A printer in Mason City must charge $19.95 for the same job. As one of our members told me:

> "We take advantage of the service of the Post Office to order envelopes much cheaper than we could buy envelopes, much less to have them printed. It is direct competition...."

Here are additional examples of how taxpayer money is used to compete with taxpaying businesses:

High school teachers and college professors have created a vast taxpayer-financed publishing industry. As one book publisher told me, "You can walk into any college book store and see any number of materials prepared by local professors and published by the college."

A small town printer wrote this comment to me:

> "Our local ASCS (Agricultural Stabilization and Conservation Service) office prints as a service to beef producers, pork producers, and other organizations all of their dinner, pancake feed, soup suppers, etc., tickets plus any literature they might need -- at no charge. It seems that since printers pay taxes to support our government office, that the printers should be able to print the in-house printing that is done in these offices. There is no way that I can estimate the financial loss to my shop alone."

An accountant listed these examples of government-financed competition, in the area of consulting:

> "The State Auditor's office performs audits of local government units in direct competition to us. SCORE (associated with SBA) performs free management advice counseling to firms. CIRAS, from Iowa State University Extension, provides services to businesses that could be done by CPAs and various other professionals."

A custodial business in an Iowa community of 25,000 population reports losing about $75,000 gross per year from work lost to government agencies. The owner of this business states, "Governments almost always provide their own custodial staffs. There is never a chance for small 'outsiders' to bid on these jobs."

Job Service competes with private job placement businesses in recruiting and finding new jobs for persons already employed. Many employers wonder why Job Service has gotten into the business of raiding persons already working for them. As one employer stated it:

> "Iowa Job Service has called up people after we have hired them, and offered them other jobs under VA training programs even though they knew that we had just hired them."

Congress would do well to probe deeply into the Farmers Home Administration (FmHA) activities. One business owner, in the soft water business, states:

> "Farmers Home Administration loans to Rural Water Districts millions of dollars at 4% to 5% to build long pipe systems. In some cases in Iowa, the Rural Water Systems sold water conditioners and appliances. I'll take all the 5% money they would care to loan me, and I won't spend it on systems that are more costly than other alternatives."

The FmHA director in Iowa from 1980-1981, Richard E. Myers, is a member of our Board of Advisors and sent me the following statement to include in this testimony:

> "I think the government should get out of the direct loan business to agriculture. The only exceptions might be natural disasters such as hail or drought.
>
> "The current direct loan programs should be changed to a guaranteed loan program such as the Small Business Administration runs. This would have two effects. It would keep the small farm banks and the farmers tied together so the farmers would not stay in the program forever. The bank would service the loan because it has a stake in it and therefore require less of a bureaucracy to administer the program.
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> "To demonstrate my concern, according to the Federal Reserve in February, 1981, 48% of the total agriculture debt in the country is being carried by the federal government through agencies such as FmHA, ASCS, Federal Land Bank and Production Credit Association. In FmHA alone, this figure has increased from 9% of total debt to 16% in just the last four years.

> "Of course, the banks are partly at fault. Because of current money market conditions, they are pushing the farmers toward the federal government as fast as they can. Also the bureaucracy of the USDA would fight this idea with all their resources. Why? Because they do not want to lessen their influence or control on any facet of any program. But I believe the Congress should hold their (the bankers and USDA) proverbial feet to the fire.
>
> "Finally, the best thing of all is that the direct loan dollar is an appropriated Treasury dollar while the guaranteed dollar is a local banker's dollar and therefore, I think, less inflationary. This government program has caused the banks to abdicate their lending responsibilities to the federal government, and has given the USDA too much credit responsibility in what should be a private enterprise area."
>
> "During the period I was administrator, I felt sincerely that one-fourth of my program could have been eliminated."

I have cited numerous examples of direct competition by government with business. The worst competition by government with business, however, is indirect. It affects every person and every business in the country. This is the federal government's competition for dollars.

I am not an economist. I do not attempt to outguess the numerous economists and politicians who themselves cannot agree on the causes of our present inflation/recession/high interest/high unemployment economy.

However, I do have expertise of a kind which I share with millions of other workers and small business people in America. Expertise that qualifies me to express some strong opinions. I have the expertise, simply, of surviving in a sustained period of 16% to 21% interest rates. One thing seems very clear to all of us out there across the land, the unemployed, the under-employed, the bankrupt merchants, and the vast millions of small business owners who are going bankrupt. Excessive government spending is competing with us for scarce dollars.

One of the clearest statements of this reality was made on Sept. 14, 1981, on the MacNeil-Lehrer Report, by David Jones, an economist in the bond and money markets with the investment firm of Aubrey G. Lanston and Company. Mr. Jones stated:

> "And the reality is really two things, not only the deficit. The other very harsh reality is that our Federal Reserve has set for the economy in 1981 and 1982 two very tough and very tight monetary targets. And in fact, the Federal Reserve was so tight and tough almost to the point of overkill earlier this year that money growth is in fact below the target. We're talking about less than 2% money growth this year and we're talking about a very low growth rate next. There is not much new money to go around, and if the federal government comes in -- elbows its way into the market -- very few borrowers are going to have anything left over -- state and local governments, mortgage borrowers, and most importantly, small businesses will have nothing left."

The letters and telephone calls I receive from small business employers tell me that people at the grass roots are angry. Your mail and your phone calls must be telling you the same. You must be hearing comments just like this one, from one of my members:

> "We would certainly support cuts in the salaries and budgets of the Congressmen -- massive cuts -- let them bite the bullet first and show the rest of us the way. They are wasting billions with their unrestrained spending. Do hope you will be able to get that message across to them. The masses have had it with the lavish spending by the Congressmen and bureaucrats."

That message was followed by this letter from a southern Iowa farm implement dealer:

> "Our company was founded over 20 years ago by the original owner whom we bought out in 1972. Since that time, we have shown a steady growth until the first onset of 20% rates in 1980. Currently, our net sales at this time are barely 40% of our 1979 rate. It does not take a genius to determine that we are now fighting for survival, as are most other small businessmen. We were able to progress with inflation, but if we can't have some relief SOON, our company could become extinct....
>
> "As for Paul Volcker, impeachment is entirely too good for him and his entire Federal Reserve outfit. I prefer burning at the stake! How any intelligent person can honestly believe that inflation can be reduced by passing on 20% interest is beyond my comprehension....
>
> "I have maintained for some time that although it is extremely distasteful, the government should have clamped on price and wage control for at least a year, during which time federal spending could have been reduced to a great degree. In this fashion, we could have held inflation in check, and business could have continued to operate. As it is now, how many of us are going to be left to pay taxes, let alone benefit from any cut in taxes?...

> "Currently, I have seen prices increase on farm tractors three times since Jan. 1, 1981, and each increase averages from 4% to 8%. How can this result in a lowering of inflation? The plain fact is that the Fed's policy IS NOT WORKING now, and common sense tells us that it NEVER WILL! It will be slight consolation to those business men who are forced into bankruptcy to hear a year or so from now that Paul Volcker is sorry but he THOUGHT it would work....
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> "I fully realize that my observations border on the ridiculous, because it is simplistic to believe that any of the above will have any impact on anyone in a position of power. But at least I have had the satisfaction of saying something to someone."

Of all the instances of government competition with small business that I have mentioned, the most damaging to all small businesses is government's competition for capital. Every other effort by the Congress to stimulate and promote the small business sector will result in failure, until government competition for capital is ended.

The small business economy is nearing a depression. Many small businesses in the past 18 months have gone bankrupt. Even more may go bankrupt in the next 12 months. The damage being done now by government's competition for capital will take years to mend. The longer you in the Congress permit this competition to continue, the greater will be the human tragedy--the depressed towns, the bankrupt employers, and the workers thrown out on the junkheap of unemployment.

Senator **Jepsen**. Congressman Reuss.

Representative **Reuss**. Thank you, Mr. Chairman.

I agree with Chairman Jepsen that you have told it like it is. I think particularly your analysis of the murderously high-interest rates that small business is now suffering from being the joint result of an overtight Federal Reserve monetary policy and an overloose government fiscal policy is right on target. I congratulate the small businessmen of Iowa and you for telling us this whole truth.

Did you happen to be in the hearing room earlier this morning when I was examining Budget Director Stockman?

Mr. **Collison**. Yes.

Representative **Reuss**. Do you agree with the point I was making?

Mr. **Collison**. I would have to say that virtually all of the small business people we have been talking to in the last few months are extremely concerned about this subject. Most of them will agree that they are not economists and they are not experts and they don't know which is the right policy and they are very confused, but they do know one thing—their bottom line. And their bottom line is, whatever the policies have been for many, many years, something is not working because they are going out of business or they are on the verge of going out of business.

This current economic situation began to affect my own business 18 months ago and I thought that if I could survive a year things would begin to turn around. Well, we are now past that point and not only I but many, many other small businesses are looking at this winter and we're saying we may be able to hold on with our fingernails through this winter but if things don't begin to get better, many, many of us are going to be falling off that cliff. I think we are on the verge of a tragedy in this country and I'm no expert. I can't say whether current policies are the right ones or the wrong ones, but I can say that up until now they're not helping us and we are in trouble and something has to be done. And if the current policies don't work, then something has to be done very, very soon to save hundreds of thousands of small businesses. And if these small businesses are destroyed, it's going to take years to recover from that, because it's in the small business sector where the new jobs are created, where the innovation comes, and I think that more attention has to be given to that problem.

Representative **Reuss**. You've said that current policies obviously aren't working and that something has to be done. As I indicated before, the administration has directed that the Federal Reserve lower its monetary targets, tighten money, as of this next January 1; that's 2 months off. As you heard me say, this distresses me because I think that's going in the wrong direction.

What would your view be on that and would you join me in opposing that action by the administration and the Federal Reserve?

Mr. **Collison**. I have a feeling most small business people are getting ready to say that the monetary policy should be let up on. I was asked yesterday if my testimony indicated that I no longer—or that business people no longer supported Reaganomics. And my answer—and this may answer the question you have given—was that as I see Reaganomics, it involves three things: it involves the cutting of Government spending; it involves tax cuts; and in the past it has been support of the current Fed tight money policy.

I know that in the past 18 months many, many or most business people supported those three aspects of what have become Reaganomics. I think business people strongly support and will continue to support cutting Government expenditures. We get into disagreements on where cuts should come. I think that's not unusual. I happen to find that there are more and more business people who are ready to look positively at greater cuts in the military budget, which I think has been a change over the last 12 months. But, in general, business people strongly support cuts in spending and will continue to do that.

I think that business people are ready to start looking at some increases in taxes if the current policy does not work. I don't think that we are ready to rubber stamp any call for increased taxes today. After all, they just went into effect. But I think we are all openminded, very openminded at looking at this situation very closely and ready to support some increase in taxes in the future if it appears that they are needed.

As far as tight money policy, again, I don't think any of us in the small business community claim to be economists and I don't think that I can say more than that because I'm not an economist and I'm not experienced enough or educated enough in that area to comment on the intricacies of the Fed policy.

My gut feeling is that high interest rates are not a long-term solution to inflation. That's a gut feeling I have, but it's one that comes I think from commonsense and not from any book learning or expertise in the area.

Representative REUSS. You have said, Mr. Collison, that most Iowa small businessmen would favor a somewhat less tight monetary policy. If that is so—and I'm sure it is—wouldn't you be even more upset about the prospect of moneys becoming, by order of the administration, acquiesced in by the Federal Reserve, even tighter as of January 1 with the monetary targets actually reduced over what they have been this year?

Mr. COLLISON. I don't think it's surprising to say that any additional tightening of money is going to hurt virtually all small business people and we don't look forward to that possibility with any joy. We hope that the people in Washington can find better alternatives to solve this serious problem.

Representative REUSS. One alternative I have suggested is not to tighten money further, not to lower the targets on January 1. Does that seem like a reasonable proposition?

Mr. COLLISON. Well, again, as a person who's not an expert and just a business person from Iowa, I think most of us would say we would like to see a lessening of the tight money policy right now, but I really believe that the problem is much more complicated than that. I don't think any of us want a 2- or 3-month solution that is going to result in worse problems 6 months down the road, and I think in this area of monetary policy I do not have the expertise to explore the technicalities of monetary policy.

Representative REUSS. Well, then, I just want to be sure of your position. You have no objection to the administration and the Federal Reserve, as of this coming January 1, further lowering the monetary targets and thus further tightening money over what it is now?

Mr. Collison. I'm telling you what my opinion is and what I feel the opinion of most business people I have talked to is and will be in the months ahead, and our gut feeling—our desire is that the monetary policy not be as tight as it is. Now whether that is from an expert's point of view the correct policy, I can't comment on. I can tell you how most of us feel, and most of us feel something has been seriously wrong and that probably is one of the things that has been wrong and we would like to see something changed.

Now if you want to take, and if the Congress wants to take, the opinion of those of us who are simply out there making a living and trying to continue to make a living, I'll give you my opinion.

Representative Reuss. I can't think of any better group from whom to get an opinion. And I thank you for giving it. We appreciate you coming.

Senator Jepsen. Thank you, Mr. Collison.

Are the requirements for doing business with government so difficult that, in your opinion, many businesses simply don't want to do business with the government?

Mr. Collison. That is absolutely correct. For many years much of my business was with government agencies, both at the local level and the Federal level, and I did not like that kind of business. It was difficult business to engage in because of the contracting involved.

Just as one example, I think the first contract I ever had with the Government—and this was probably 15 or more years ago—I subcontracted with a major contractor to write and design a civil defense booklet. The civil defense booklet I believe, if my memory is correct, was an 8-page booklet and it also had a very large foldout map, but in essence it was an 8- to 12-page booklet. The contract, as I recall, was 64 or 84 pages long. In other words, the contract that I had to sign was probably 10 times longer than the booklet that I had to end up designing which to me was kind of ridiculous.

If I had contracted with a business to design an eight page booklet, my contract probably would have been a letter of agreement running one page.

So most small businesses, their attitude right now is we don't want to do business with the Government. It's too much bother.

Senator Jepsen. Apart from the questions of lowering the interest rates, what are the things that small businessmen, in your opinion, need most?

Mr. Collison. What business needs most are customers and customers who have money to spend and so, beyond that, I think that ties in directly with money policy and the economy and so on. But I think the question you're asking is, that aside, what is the biggest problem facing small business?

I think the biggest problems facing most small businesses are in two areas. One is what I call management headaches. These are problems involved with all the things that a small business owner has to do in running his business or her business. The small business owner has to be a jack-of-all-trades and is only a master of a few, and unlike the chief executive officer of a large corporation, the small business owner has to be almost everything to that business.

As a result, his or her business often suffers from the lack of expertise. So this problem of not exactly knowing how to run the business in all the areas and making mistakes in many areas is an ongoing problem for businesses.

The second area which I feel Government is directly involved in causing some of these problems is in the area of what I call payroll problems. And these deal with all the Government laws and Government programs that increase the cost of hiring people. And this means the increase in social security taxes, the unemployment insurance problems, the workers compensation problems, the Government policies that increase costs of health care so that the employer's health care costs are increased. Those areas are continuing problems.

Senator JEPSEN. Are there any sectors of the Iowa small business community that have been hit harder than others?

Mr. COLLISON. Any segments?

Senator JEPSEN. Any sectors?

Mr. COLLISON. By the economy?

Senator JEPSEN. Yes.

Mr. COLLISON. Yes. The greatest problem area is in the area of construction, primarily in new home construction, real estate sales. Real estate sales people are in severe trouble and this is not unusual to Iowa or the Midwest. And the automobile dealers and the farm implement dealers.

Now the one area that may be unique to Iowa and the Midwest would be all of the businesses that are directly related to agriculture. And because of the problem in the agriculture economy today because of depressed prices, many, many small businesses in the small communities are hurting because of the problems in the agriculture economy.

Senator JEPSEN. Well, I do thank you for being here today.

Just for the record, there are four parts to the economic recovery activities of the President. As you indicated, one is spending reform; one is tax reform; and in addition to the stable monetary policy, we have regulatory reform which is what we have been kind of addressing here in the last few minutes—the reams and reams of paperwork that takes place.

In a meeting with Mr. Stockman that I had with Bill Nelson from Des Moines not too long ago, it was indicated that to start to do business with the Government, just to kind of get in place, you have some 250-plus forms to fill out. Now those type of things have no place in the real world whatsoever. It's that type of thing, with the no-nonsense people we have—and many of them are around here today—we hope to do something about.

Regulatory reform is going full speed ahead here. The Vice President is in charge of coordinating the effort. I would anticipate there will be some major overhaul and streamlining of this, certainly in the small business area, in the very, very near future.

Thank you very much for coming. We will now take a 5-minute recess after which time we will reconvene and we will have Milton D. Stewart, editor of Inc. Magazine, coming before us.

[A short recess was taken.]

Senator **Jepsen**. I wish to welcome Milton D. Stewart, editor of Inc. Magazine. Mr. Stewart, welcome to Washington, and we look forward to hearing your testimony.

STATEMENT OF MILTON D. STEWART, EDITOR OF INC. MAGAZINE, BOSTON, MASS.

Mr. **Stewart**. Thank you, Mr. Chairman. I'd like, if I may, to submit my prepared statement for the record and ask the right to make some changes in it as we push along.

Senator **Jepsen**. Your prepared statement will be printed in the hearing record, subject to your caveats about making changes.

Mr. **Stewart**. Mr. Chairman, I'm going to keep the record, in terms of my comments here, as short as I can and therefore will not repeat what's been said here before by Mr. Stockman and Mr. Collison.

With respect to the comments of the Director of Management and Budget, Mr. Stockman, on the Government competition issue, let me say, as an alumnus of the institution which he heads, I was delighted to hear them. I only hope he has the tenacity and the sense of urgency about this problem which will enable him to make the progress that I think is needed.

I have, in my prepared statement, elaborated in several directions from the issue that's directly before you in ways that I think are uniquely important to this committee.

This committee historically was charged with being the public's representative in the Congress with respect, above all, to the issue of full employment. That goes back to 1946 and the Full Employment Act.

I'd like to refer for a minute if I may to the last appendix to my prepared statement in which we report for Inc. Magazine the growth in employment of small companies as against large ones. I won't elaborate except to say that this committee has a long overdue rendezvous with some facts about employment to which I do not think it has given adequate attention.

Over the years, this committee has dealt with full employment on a random basis and has never performed for the Congress the function of cumulating the impact of all Federal policies on employment, taxes, regulation, capital, and credit, the variety of those matters.

Let me digress and advise you for the record and your chairman, Congressman Reuss, that small business or at least a sample of it has answered his question about interest rates. In a survey which I will summarize in an appendix which I will add to the record done by the Roper people a year ago, a majority of the small business people in this country do not believe the high interest rates help to control inflation. You remember Congressman Reuss tried to find an answer to that question from Mr. Collison.

The answer is in a survey done for the Heller Institute by the Roper poll, small business in this country does not believe that high interest rates help to control inflation.

On the contrary, it really believes that they add to it. That's simply a fact I think the record should show.

If I may, Mr. Chairman, there are really just three charts that I'd like to show [indicating]. This is a chart which will tell this committee what kind of economy the American people want. This is based on 20,000 interviews with graduated youngsters coming out of high school. The survey was done over a 5-year period by the University of Michigan Research Center.

The columns on the left reflect those students who are going on to college and the right who are going directly to work. Regardless of whether they were going to college or going directly to work, the single career line they find most appealing and attractive is self-employment. Almost half of the youngsters in this country want to be in business for themselves.

Now what that chart shows is the perfect correlation between entrepreneurship on the left and bureaucracy on the right. It runs from self-employment through being in business with a small group of partners, through small business employment, through large corporation employment, through Government agency employment, to employment in police forces and in the military.

The depth and vigor of the entrepreneurial position in this country is no less today than it has been in the past.

The issue before you now, Government competition, is one which enrages small business people particularly because they feel in their guts that it flies in the face of this fact. What they look to their Government for is to expand the entrepreneurial opportunity, not to contract it.

This chart [indicating] depicts the biggest oversight in what we have heard today so far is the failure to relate the role of Government competition as it impacts small business with the role also of what I've called government-sized business in the private sector.

For example, Mr. Stockman used the word "turnaround" in describing what the Reagan administration is trying to do. Small business will applaud everything this administration does to limit the size of Government, but the turnaround sought is only a half-turn if it turns in the direction of the private sector without going any further.

What we need is to begin to be more alert when we talk about the private sector in distinguishing small business from large business. These data reflect a 4- to 5-percent drop in the gross domestic product share of small business, defined here as firms with under 500 employees, as against big business, defined here as simply firms with over 500 employees; and what you see at the beginning, from 1955 to 1972, there was a transposition.

Small business had been 43 percent of the gross domestic product. It is now 39 percent. Large business had been 40 percent. It's now 43 percent. The difference was made up by Government. The chart then goes on to project that trend if it goes on without interruption and it shows Government coming under control—we believe that's what will happen—but it shows that by 1990, instead of the 50 percent of the private sector in the gross domestic product, which the White House conference said in 1960 small business should have, it's shrinking to 35 percent. That 15 percent, Mr. Chairman, equals $900 billion in gross domestic product and that is as much the issue before the committee as the issue of Government competition.

Will that share of the economy be in small business or in large business? Let me refine the issue a little further.

Here is a clarification [indicating], if you will, of what that chart showed. This compares the share of gross domestic product in microbusinesses, those with fewer than 20 employees, with government-size businesses, those with 5,000 or more employees. We're not just talking about large companies now. We're talking about companies which are as large or larger than half the governmental units in the United States. And, again, what we find is a clear shift of approximately 4 or 5 percent of the gross domestic product from microbusiness to government-size business.

Let me suggest as tactfully as I can that is an important beginning point for this committee in its work in the Congress which it has not yet faced up to. If you want to know, for example, why our inflation policies do not work as well as they should, regardless of who the President is, you must go beyond the exchange which Congressman Reuss had with Mr. Stockman and you must go beyond the exchanges which he had with Mr. Collison.

Instead of asking, will monetary policies work if they are tighter; you must ask, which part of the private sector will they impact and will they work for that part of the private sector?

It is the failure to make this distinction that has, I believe, been at the root of the failure of the Federal Reserve's policies to work.

Large companies in this country are not particularly adversely affected by changes in interest rates or money availability. They go abroad. The Eurodollar market has taken $600 billion from the grassroots of this country and sent it overseas. The failure to limit the size of CD's in banks means that the Federal Reserve, for example, has much less power to control inflation than it acts like it has until you talk to it privately.

In this failure to distinguish an impact between the large business sector and the small business sector—and that failure runs through monetary policy, fiscal policy, regulatory policy, tax policy—is the root of the Fed's failure with respect to the economy generally.

Expanding the small business sector is the only way we will get and keep full employment in the United States, for reasons given in the data that I have attached to my statement. It is small business that makes jobs with the dollars the Government does not take out of it. Large business places it in equipment. That's important. But, by and large, it uses it in ways that do not add to numbers of employees.

I have in the last week, Senator, been in your part of the country twice, the upper Midwest, which in this recession is the hardest hit part of the country. In 1974, in places like Minnesota, you didn't even know there was a recession. It's different now. The difference is the impact on the large businesses in those areas which have now spread to the small businesses. Where you've got oil and construction and farm equipment altogether with the farm equipment, you've got the maximum impact, in my view, of the disastrous monetary policies we are following—disastrous not because we are tightening credit. It's because of who we are tightening it for. We are tightening it for exactly the wrong half of the private sector. We are tightening it in small business which does not create inflation but suffers its consequences, and not for large business which, with government, does create inflation.

That may appear at first blush to be a digression from the issue of government competition. It is not. If all the attack on government competition is to move employees, assets, activity, from the government to government-size business, people of a conservative temperament or bent of mind may feel better. The economy will be no better. We will simply have shifted from public bureaucracy to corporate bureaucracy that which we should be shifting into the entrepreneurial sector of the economy.

The committee has a magnificent opportunity in the months ahead to focus the attention of the Congress on this fact and to do it by holding, for example, joint hearings on the President's four messages—because he must now make four—a new one on small business competition that no President has ever been called on to make before. If this committee will call together the senior members of the Senate Finance and House Ways and Means Committees, the Senate and House Budget Committees, the Senate and House Appropriations Committees, and you all take those four messages and begin to review the impact of all of them on the Government, on large business and on small business, you will perform a major educational service to the people of the country and to their Government. It is the failure to cumulate all of these policies.

Let me digress a minute about taxes. If you were a manufacturer in Des Moines, Senator, in 1975, or in New York, Mr. Richmond, and you grossed $500,000, you paid 30 percent of the net worth of your business in Federal, State, and local taxes. If you were a manufacturer who grossed $5 million, you paid 20 percent. If you grossed a million and a half, you paid 11.5 percent.

I've used those figures before congressional committees at least a half a dozen times. I'm still waiting for the Senate Finance Committee and the House Ways and Means Committee to begin to acknowledge them within the tax bills.

The last tax measure, welcome as it is in terms of reduction of taxes, is no big help in terms of redistributing burden and redistributing opportunity to small and large business. To begin to move in those directions on a bipartisan basis, in my view, is the highest challenge this committee has before it. I hope you can meet it. We'll try to help you. Thank you very much.

Senator **Jepsen**. Thank you. You're very forceful and I appreciate your candor. I found myself agreeing with most of the things that you said. I do think there was considerable assistance to the small business area given when we restructured the tax bill. There was an awful lot of thought given to stimulation on the supply side. If we're going to make the supply side work, every segment of the economy has to be viable, moving, and expanding. And we need all the incentives we can to get the economy moving.

I would personally like to visit with you, so let's set a time when we can do that. I hear your challenge and your suggestions as to what this committee ought to do. I will discuss them with the chairman. I think it's well taken. This committee must, among other things, serve as a prod in some cases, as a forum, as an instigator and motivator to get things moving.

We can do that and, over the years, have many times performed admirably in that area. And at other times we have dropped the ball. I know we don't want to drop the ball.

I appreciate your testimony. I will now ask Congressman Richmond to take this over. As I think my staff indicated to you, I have to go introduce the Secretary of Agriculture for a major soil conservation program.

Mr. **Stewart**. I appreciate being here, Mr. Chairman.

Senator **Jepsen**. Thank you.

[The prepared statement of Mr. Stewart, together with appendixes, follows:]

PREPARED STATEMENT OF MILTON D. STEWART

A. Introduction

Eight months ago, I left the Federal Government after more than six assignments in it. For some 27 months (December 1978 to March 1981) I served in the Small Business Administration, most of it as the first Presidentially appointed Chief Counsel for Advocacy. My responsibilities included service as counsel to the 1980 White House Conference on Small Business. In both of those capacities, I had to deal with the issue of direct and indirect competition with small business.

An excerpt is attached from the report of a task force on this subject which I named in 1979 and which reported in 1980. The task force consisted entirely of private citizens, almost all of them small business people. They worked selflessly and diligently to produce what is, in my opinion, the best single document on the subject.

There is also attached an excerpt from the final recommendation from the White House Conference on Small Business. These recommendations deal directly with the need to end government competition with small business.

Since leaving the government, my experience in the private sector has reinforced the judgments about this subject made in both of those documents.

In all three capacities, I have found government competition to be a serious source of small business bitterness and disaffection with the government and its activities. Small business people view it as the tip of an iceberg of federal hostility and insensitivity. The rest of the iceberg consists of tax policies, regulatory policy, credit policy, capital formation policies, procurement policies, data collection and record keeping policies, and national goal setting policies.

Melting that iceberg during the 1980's is the task to which thousands of small business people have now committed themselves. They want their Congress and their President to make the creation of a national committee favorable to the growth of the independent small business sector their highest national priority, at least for the rest of the 1980's.

This Committee has a great potential role to play in that effort -- a role which it has not yet assumed. Using its good offices to mount an effective campaign against government with small business is only the first step. What we need that step to be part of is a federal turnaround. Limiting the size of government and disciplining the government's direct and indirect competition with small business is only the beginning of that turnaround. The rest of it is understanding the critical relationship between the expansion of the small business sector and the national goals which are supposed to be at the center of this Committee's mission.

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There will be no full employment in our country without a sizeable expansion of small business, relative to the size of government and government-sized business.

There will be no restoration of American technology and innovative world leadership without that same small business expansion.

There will be no permanent end to stagflation without the expansion of the hard-driving, competitive small business sector.

There will be no proliferation of competitive energy sources at prices the citizenry can afford to pay without that small business expansion.

There will be no singular improvement in the American foreign trade balance position, nor in American ability to help the rest of the world without that small business expansion.

B. Government Competition

With respect to government Competition, this committee should use its best offices to push the Hayakawa - Dreier Joint Resolution. If I were a Senator, or a member of the House, I would want the resolution amended to make it plain that the highest priority in carrying out the resolution should be given to those activities in which the government competes with small business. My reason is obvious: those activites are far more damaging, and small business is far less able to cope with them than is big business.

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This Committee and its members should also use their good offices with the Government Operations Committees to see to it that the oversights required for effect implementation of the purpose of Circular A76 and the Hayakawa - Dreier resolution is actually carried out, agency by agency.

Circular A76 has theoretically been in effect for over a quarter of a century. It is typical of executive branch treatment of small business matters that at this late date there is still $10 billion of potentially private sector activity (my task force's very conservative estimate) that is being performed by a full 25% of the total executive branch work force (according to the General Accounting Office's estimate.)

Whatever the reality of the size of the problem, it is clear that the damage to the taxpayers does not stop with the direct effects of the competition. Among the consequences is the crowding out that takes place with the money market that finances competitive activities of government. They must be paid for either with tax dollars or with borrowed dollars; in either case, they are a needless burden on the private sector.

The depression-born trade union strategy of using public payrolls to raise private wages is no longer defensible. So far as I am concerned, employment in government is no more or less desireable than employment in government-sized business; the trade union movement in this country would get far more respect from those who helped it when it needed help if it gave a higher priority to the need of most low-paid unskilled

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workers and a far lesser one to organizing federal employees and to trying to increase the size of the public sector.

More than 25 years after A76 was promulgated, it has been circumvented by the inclusion of state and local governments and the non-profit sector as part of private enterprise. Whatever their needs may be, it is ridiculous and self-defeating to try to piggyback them on A76. In the same way, a jungle of bureaucratic nonsense surrounds the process of deciding whether it is cheaper to make or do something with federal employees than in the private sector. All of these have obviously been devices by special interests and politicians and bureaucrats sensitive to them to emasculate the simple policy which A76 set out. Certainly, an absolutely simple arbitrary presumption should be made about every activity involving fewer than 100 people or $1 million.

Indirect federal competition fostered by well-intentioned but blundering efforts that beef up support for non-profit sector institutions are legion in the federal bureaucracy.

Two new forms of government competition promise to challenge the ingenuity of the President and the Congress even more in the year ahead. Consider the acquisition of a big deal company (Texasgulf Sulphur) by Elf Acquitaine, a French company controlled by the French government. Here is a major American corporation competing with others large and small now controlled -- not be our own government -- but by the government of a foreign country. Whether the Kuwait oil company is a direct or indirect arm of the government of Kuwait, I do not know; but if I were a member of the Congress of the United States, I would be

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deeply concerned by the proposed acquisition of Santa Fe International.

The House Committee on Science and Technology has already begun to make a record of the "acquisition" of major non-profit American research institutions by foreign and domestic government-sized businesses. The Hoechst Company, a German multi-national chemical company, has "given" $50 million to the Massachusetts General Hospital for bioengineering research in genetics; "all" it is getting in return is a right of first refusal on patentable products which result from the research. The acting Controller General of the United States has already found it necessary to tell this "non-profit" institution about how to keep its books so that activities financed by federal funds may be separately accounted for from those paid for by this government-sized German business. Similar arrangements are springing up between American government-sized businesses and other government-sized ostensibly non-profit institutions.

The results of all of these relationships will prejudice the small business sector; all of them, in my view, represent a misuse of government and government-conferred benefits to fund government competition with small companies.

Ways must be found to achieve proper goals of non-profit institutions without corrupting their proper purposes, the commitments for which they have been given tax exemption and the commercial marketplaces into which they are being dragged. These are examples of the elimination of what should be hard and fast walls between entities of different legal standing and different economic purposes. Few Americans, I believe, find corporate socialism or non-profit institutional socialism any more

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palateable than outright government socialism.

C. Full Employment and the President's New Responsibilities

By January 20, the President is required to submit to the Congress a new and fourth message on our national position as he sees it. In addition to his messages on the state of the union, the budget, and his report on the economy, he must now report on "small business and competition" as the result of an enactment of the last Congress. Just last week, the President described high technology small businesses as "the job-producing lifeblood of our economy" (letter to Senator Warren Rudman from President Ronald Reagan, October 6, 1981). That was an encouraging acknowledgement of the critical role of small business in achieving full employment in our economy. The federal government has been incredibly tardy in understanding and responding to the new data on small business and full employment. The pioneering work of Professor David Birch of MIT has now been confirmed by other researchers in the United States and abroad. Data about this central role of small business in achieving full employment is supplemented by particular data which puts it at the center of technology advance; research supplied by the National Science Foundation confirms that small scale technology companies achieve more than twice the number of applied science innovations that large companies do, based on the number of employees.

The very purpose for which this Joint Committee was established demands that it play a far more aggressive role in appraising the cumulative impact of federal policies on the size and profitability of the small business sector. It should be taking the lead in pulling together the concerns of the Senate Committee on Finance and the House Committee

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on Ways and Means with those of the Committee on the Budget, the Committees on Banking and Currency, and ther other pertinent committees of the Congress.

One of the greatest weaknesses in the making of a federal policy about the economy has been this failure to cumulate the impact of all federal policies on those national goals which, in my view, are most furthered by the growth of the small business sector.

This Committee should use its good offices to see that the President's new message is full and forthright; with the Committee on Small Business, it should see to it that the message deals with government competition, taxes, regulations, capital, credit, credit availability and cost, and the other federal policies that impact small business. One specific way in which you might help both policy makers and the citizenry to understand the economy is to run a Joint hearing by the senior members of this Committee along with the senior members of at least five other committees in each chamber. The subject of the hearings should be all four Presidential messages and how they relate.

Such a hearing and a report based on it would make a major contribution if it finally forces the federal government to look at its across the board impact on the structure of the American economy. We might just possibly then do a better job of seeing to it that the variety of federal functions were done in a way which pulled in the same direction -- one hopefully selected by a majority of the American people.

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APPENDIX I

AREAS IN WHICH GOVERNMENT COMPETES WITH SMALL BUSINESS

I. DIRECT COMPETITION

A. INSTITUTIONAL COMPETITION AT THE AGENCY LEVEL -- WHERE THE DECISION TO PROVIDE CERTAIN COMMERCIAL AND INDUSTRIAL GOODS AND SERVICES IS MADE AT THE AGENCY LEVEL.

1. Audio-visual products and services

   Photography (still, movie, aerial, etc.)
   Photographic processing (developing, printing, enlarging, etc.)
   Film and videotape production (script writing, direction, animation, editing, acting, etc.)
   Microfilming and other microforms
   Art and graphics services
   Distribution of audio-visual materials
   Reproduction and duplication of audio-visual products

2. Automatic Data Processing

   ADP services -- batch processing, time-sharing, etc.
   Programming and systems analysis, design, development, and simulation
   Key punching and data entry services
   Systems engineering and installation
   Equipment installation, operation, and maintenance

3. Printing and Reproduction

   Printing and binding (where the agency is not required to submit the item to the Government Printing Office)
   Reproduction, copying, and duplication
   Blue printing

4. Office Services

   Stenographic recording and transcribing
   Word processing/data entry
   Mail/messenger
   Translation
   Information systems and distribution
   Financial auditing and services
   Management auditing

5. Research and Development

   Basic research
   Applied research
   Development
   Concept formulation and demonstration
   R&D studies, testing and support services

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6. Manufacturing, Fabrication, Processing, and Packaging

Ordnance equipment
Clothing and fabric products
Liquid, gaseous, and chemical products
Logging and lumber products
Communications and electronics equipment
Rubber and plastic products
Optical and related products
Sheet metal and foundry products
Machined products
Construction materials
Test and instrumentation equipment

7. Systems Engineering, Installation, Operation, and Maintenance

Communications systems -- voice, message, data; radio, wire microwave
Radar detection and tracking
Television systems -- studio and transmission equipment, distribution systems, receivers, antennas, etc.
Recreational areas
Bulk storage facilities

8. Maintenance, Overhaul, and Repair of Equipment

Aircraft and aircraft components
Ships, boats and components
Motor vehicles
Combat vehicles
Railway systems
Electronic equipment and systems
Weapons and weapon systems
Medical and dental equipment
Office furniture and equipment
Industrial plant and equipment
Photographic equipment

9. Real Property

Design, engineering, construction, modification, repair, and maintenance of buildings and structures
Construction, alteration, repair, and maintenance of roads and other surfaced areas
Landscaping, drainage, mowing and care of grounds

10. Industrial Shops and Services

Machine, carpentry, electrical and other shops
Industrial gas production and recharging
Equipment and instrument fabrication, repair and calibration
Plumbing, heating, electrical, and air conditioning services, including repair
Fire protection and prevention services
Custodial and janitorial services
Refuse collection and processing

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11. Security

Guard and protective services
Systems engineering, installation, and maintenance of secrutiy systems and individual privacy systems
Forensic laboratories

12. Food Services

Operation of cafeterias, mess halls, kitchens, bakeries, dairies and commissaries
Vending machines
Ice and water

13. Other Services

Laundry and dry cleaning
Library operation
Mapping and charting
Architect and engineer services
Geological serveys
Cataloguing
Training -- academic, technical, vocational and specialized
Operation of utility systems (power, gas, water, steam, and sewage)

14. Health Services

Surgical, medical, dental, and psychiatric care
Hospitalization, outpatient, and nursing care
Physical examinations
Eye and hearing examinations -- manufacturing and fitting glasses and hearing aids
Medical and dental laboratories
Dispensaries
Preventive medicine
Dietary services
Veterinary services

15. Transportation

Operation of motor pools
Bus service
Vehicle operation
Trucking and hauling

B. INSTITUTIONAL COMPETITION AT THE LEGISLATIVE LEVEL -- WHERE THROUGH LEGISLATION GOVERNMENT AGENCIES ARE DIRECTED TO PROVIDE CERTAIN COMMERCIAL AND INDUSTRIAL GOODS IN COMPETITION WITH THE PRIVATE SECTOR

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1. Federal Agencies

    a. Government Printing Office -- printing services

    b. U.S. Postal Service -- mail distribution, monopoly over letter carriage

    c. Military Post Exchange

    d. Army Corps of Engineers

    e. Federal Laboratories

    f. GSA Stores/Depots

2. State and Local Agencies

    a. Fire, Sewage, Garbage Disposal

    b. State Alcoholic Beverage Stores

    c. Parks, Recreation Facilities

II. INDIRECT COMPETITION

A. INDIRECT COMPETITION BY GOVERNMENT THROUGH GRANTS AND SUBSIDIES TO PRIVATE NON-PROFIT ORGANIZATIONS WHICH COMPETE WITH SMALL BUSINESS, e.g., COMMUNITY SERVICES ADMINISTRATION FUNDING OF PRIVATE NON-PROFIT COMPANIES WHCIH COMPETE WITH SMALL BUSINESS AND A FEDERALLY SUPPORTED UNIVERSITY WHICH CONSTRUCTS MOTELS IN COMPETITION WITH SMALL BUSINESS

B. INDIRECT COMPETITION BY GOVERNMENT THROUGH INDIRECT SUBSIDIES TO PRIVATE NON-PROFIT ORGANIZATIONS IN THE FORM OF INCOME AND PROPERTY TAX EXEMPTIONS WHERE THESE NON-PROFITS SELL TO THE PRIVATE SECTOR IN COMPETITION WITH SMALL BUSINESS

C. INDIRECT COMPETITION BY THE FEDERAL GOVERNMENT THROUGH GRANTS TO STATE AND LOCAL AGENCIES WHICH PROVIDE COMMERCIAL AND INDUSTRIAL SERVICES IN COMPETITION WITH SMALL BUSINESS

    1. Revenue sharing funds or "no strings attached" funds
    2. Funds directed at specific goals -- e.g., Small Business Development Centers funded by SBA; and Federal funding of state employment services which compete with private placement services.

Source: Testimony presented to the Task Group and data derived from Contracting-Out: An Overview of the Market and the Issues, Government Division, Electronic Industries Association.

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APPENDIX II

Taken from: The Report of the White House Committee on Small Business,

April 1980

26: The Federal Government shall be required by statute to contract out to small business those supplies and services that the private sector can provide. The government should not compete with the private sector by accomplishing these efforts with its own or non-profit personnel and facilities. Small business generally -- 50% which shall include the following· minority-owned businesses 15%; businesses owned by women 10%.

27: Procurement agencies should break down large requirements (including those for research and development) into smaller parts where feasible to permit solicitation from, and award to, small businesses.

28: The Federal Government should contract out supplies and services to private industry (particularly small minority business) and should not compete with the private sector either through the use of its own personnel or through non-profit organizations such as the Federal Research Centers, educational institutions or other non-profit entities.

29: The Office of Federal Procurement Policy should develop a new set of procurement regulations applicable to procurements under a special amount from all businesses. This "second-tier" regulation should eliminate clauses, procedures, reporting requirements, etc., applicable only to large systems procurement which are currently imposed on small businesses, as well; and to the extent possible, apply to subcontracts with small businesses.

30: Congress should adopt legislation establishing separate mandatory goals for all federal procurements and Federal funds or grants to states, localities, and public and private institutions on a contract-by-contract basis or agency-wide basis for small business (35%), minority-owned (Black, Hispanic, Native American, Asian Pacific American or other racial minorities) businesses (15%), and women in business (10%).

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APPENDIX III

JOBS AND LARGE AND SMALL BUSINESS

	Number of Employees		% Change
	'76	'80	
FORTUNE 500	14,836,163	15,909,985*	+7.2%
FORTUNE TOP 100	8,537,131	8,913,067	+4.4%
INC. PUBLICLY OWNED 100	11,623	88,732	+663%
INC. PRIVATE 100	2,332	32,684	+1,302%

EMPLOYMENT TREND IN THE AUTO INDUSTRY

	Number of Employees		Jobs Lost
	'76	'80	('76-'80)
General Motors	748,400	746,000	2,400
Ford	443,900	426,700	17,200
Chrysler	244,900	92,596	152,304
American Motors	28,900	21,400	7,500
	1,466,100	1,286,696	Lost:179,404 Down 12.2%

Compared with Inc. Private 100, the auto industry has lost 6 times as many jobs as the privately held growth companies have created (30,000 x 6 = 180,000).

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* Down from 16.2 million in 1979

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Representative **Richmond** [presiding]. Mr. Stewart, it's a pleasure to have you with us. As you know, I was a small businessman a good part of my life and had the pleasure of founding a company with $1,000 and it's now a large business, but I understand and sympathize with all small business in this country.

Your analysis on taxes I didn't quite understand. It went awful fast. You said a small business grossing $500,000—was that gross?

Mr. **Stewart**. Manufacturing and selling a half million dollars worth of equipment.

Representative **Richmond**. The sales volume?

Mr. **Stewart**. In sales.

Representative **Richmond**. Well, the sales volume doesn't—he could very well lose money on that also. The question is how much money do you make before taxes.

Mr. **Stewart**. Mr. Richmond, with all due respect——

Representative **Richmond**. You just threw three figures out as gross, but that means nothing unless we know what the net worth of the company is, what the return on capital is, and what he made.

Mr. **Stewart**. I'll concede that like a shot, but what I said was nevertheless the case and it's relevant. It makes sense and is necessary to know what the profits are and it makes sense and it's necessary to know what a lot of other things are.

Representative **Richmond**. And how much capital is involved in making that $500,000.

Mr. **Stewart**. Correct. But what I said, as you well know, if I'm a businessman sitting here trying to build a small company, the net worth of my business with what equity it's got in it, is what I look at ultimately as to how I'm doing. It's on that net worth basis that the tax structure of this country is as regressive as it is.

Representative **Richmond**. Mr. Stewart, I was able to build up a good-sized business using the present tax code and I really have very few complaints. I know small businesses don't have to pay taxes anywhere nearly as rigidly as large businesses.

Mr. **Stewart**. I think that's the case if you take certain kind of Federal income tax, but if you take, for example, payroll taxes, they pay far more in small businesses than they do in large businesses. I don't mean to overstate what I'm saying and certainly we both know small business people have done very well in some industries in holding their own in the economy in lots of ways. I still think they can do better and that by doing better they will be doing better for everybody.

Representative **Richmond**. Small business people have infinitely more tax loopholes than the big people because of their ability to—first of all, they are in a lower tax bracket. Second, they are able to do an awful lot of things that one can't do when you have a major certified public accountant reviewing your books night and day.

Mr. **Stewart**. Congressman——

Representative **Richmond**. Mr. Stewart, I was there. I know.

Mr. **Stewart**. I know you were there and I have been there too for at least as many years. Let me draw this distinction for you. What you say is emphatically true. In terms of gross impact on revenue in business, available workable capital, if you take the tax expenditure side, the last time I knew the figures we had $80 billion in tax expenditures at the Federal level alone. These are deductions, exemptions and the like. The bulk of them, 90 percent, available to large companies are not available to small companies. The situation is far less tilted than what you said would lead me to think.

Representative RICHMOND. Let's go back to those figures in your testimony. You said a small business sales——

Mr. STEWART. A small manufacturer with gross sales of half a million dollars.

Representative RICHMOND. Would do what?

Mr. STEWART. It would have paid in that year 30 percent of its net worth.

Representative RICHMOND. How do you know what the 30 percent is? How do we know what its profits were?

Mr. STEWART. We're talking about all small manufacturers with all of their net worth.

Representative RICHMOND. Maybe they lost money on that $500,000.

Mr. STEWART. What differences does it make, if they had to give up 30 percent of their net worth to the Government in taxes, whether they made or lost money? We're talking about the total impact on the economy, not to Government. We're talking about all manufacturing companies that grossed $500,000 or less. Then we're talking about all manufacturing companies that grossed $1 million or less. Then we're talking about all manufacturing companies that grossed $1½ million or more. What this figure gives you is what I don't think a lot of people in or out of Congress have understood, and that is the cumulative regressivity of the tax cut.

What we keep looking at is what a business pays to the Federal Government when you take the corporate income tax into account. When you take State and local taxes into account and you take payroll taxes into account, what is left in the business—and that's the critical factor of good management—what is left in the business is a smaller share of the business' net worth if the business is small than if it's large.

Part of that is because the large company starts with more equity and a larger equity base. Small business people use debt far more than they use equity to finance their activities. All of those things are involved.

Representative RICHMOND. And debt, as you know, is tax deductible.

Mr. STEWART. Sure, the interest on it is tax deductible, but as a part of your below-the-line balance sheet, it is damaged just as much by the exit of net worth as it is by the exit of equity. Perhaps we can take this up at another time.

Representative RICHMOND. Mr. Stewart, I can't agree with you. I would almost say the opposite. Having been a small businessman, I know that the tax—not loopholes—but the tax benefits of a small businessman far exceed those of a large business. Our whole tax structure is geared to build up small business. After all, every large business today was originally a small business.

Mr. STEWART. No question about it. Much of what you say is true. Our tax structure was not as regressive historically as it is now. What I'm telling you is that the prospect of small businesses becoming large businesses now is not as bright as they were 30, 60, or 90 years ago. More and more taxes are levied on a regressive basis which makes it easier for large companies to expand and harder for small ones to expand. I'm sorry to be taking you so far off the subject of this hearing.

Representative RICHMOND. Now profits and the sales of Fortune's 500, how would they compare with the profits and sales——

Mr. STEWART. My recollection is that the effective rate paid by larger companies in this country, largely because of the share of income which they derive from overseas sales—the effective rate is less for large companies than for small.

Representative RICHMOND. Well, you understand the average large American company doesn't derive the major part of its profits from overseas sales. The average large company operates within the continental borders of the United States.

Mr. STEWART. Congressman Richmond, it's a question of how you define the large company.

Representative RICHMOND. I'm talking about the Fortune 500. The Fortune 500 or 1,000, I can tell you that those companies, by and large, derive most of their income from domestic operations.

Mr. STEWART. No question about it. What does, however, help their tax position enormously are several things. First of all, overseas profits on which taxes may be deferred, arrangements for offsetting taxes abroad. There is one critical element in domestic tax policy, and that's the investment tax credit. Let me stop there for a minute. 80 percent of the benefit of that, as I recall it, goes to 300 companies—80 percent—and that's a big tax exemption. When we tried, as we did 5, 6, or 7 years ago to get Congress to enact a job tax credit, since ours is the labor intensive part of the economy, Congress did enact it and the Treasury killed it within 2 years before we could really test it. That's an example of the different impact of taxes ostensibly on intensity of capital equipment, but it really works out to a discriminatory tax based on size because large companies are more capital intensive.

Incidentally, it's a pleasure to talk about this kind of thing and I really think this is the sort of thing this committee should be leading the Congress in discussing.

Representative RICHMOND. Senator Jepsen has been doing that and we certainly applaud that. As you know, I have been spending more of my time on Japanese-American relations.

What did you think of Mr. Stockman's testimony this morning on the OMB Circular A-76?

Mr. STEWART. I applaud it and, as I said in my own opening remarks, I hope very much that he has the patience and the courage to carry out the position that he expressed here today. I have also said in my prepared statement that if I were a Member of Congress I would vote for Senator Hayakawa's resolution, although I would frankly amend it to give the highest priority to those matters in which the Government competes with the small business sector of the economy because the small business is less able to cope with them.

Representative RICHMOND. I certainly agree with Mr. Stockman that anything small business can and should do should be done by small business and not by our Government.

Mr. STEWART. Congressman, if you take a look at the first appendix to my prepared statement, everything I learned about this subject I learned from small business people who served on a task force I named. If you look at the list of activities there, I don't think 1 American in 100 would believe that his Government does these things in competition with small business, but it does.

Representative RICHMOND. Sure.

Mr. STEWART. That's an inventory assembled by a task force of small business people.

Representative RICHMOND. Let me discuss something else that I plan to have some indepth hearings on that I think is probably—well, I think it's the single biggest problem we have in the United States today; namely, unemployment; and not only unemployment but underemployment, and also the unemployability of large portions of our population.

For example, in New York City we have 50 percent of our minority teenagers not only unemployed but unemployable because they don't know how to go out and find a job. They're partly illiterate. Many of them have no idea of time, of clothing, of speaking and everything else, and all of that has to be taught them before they can be put into the labor market.

What can small business do to ameliorate—would you agree with me certainly that the unemployed and unemployable people in the United States are the ones that are the most troublesome because not only are they unemployed, not only do they give nothing to the tax structure in the United States, but being unemployed, they are much more likely to get involved in illegal activities than employed people. If a guy has a good job, he's not likely to wander too far. So crime, danger on the streets, the whole idea of people being prisoners, in their apartments in our urban environments because of crime—I bring all that back to the unemployability of many of the large segments of our population.

What can small business do about that if Government gave them proper credits? Because I can tell you, it's awfully hard to get large business to do anything much.

Mr. STEWART. It's not just hard; I think it's impossible; and I feel very strongly that——

Representative RICHMOND. Large businesses don't want the tax credit or the bother.

Mr. STEWART. They don't have the jobs. Large business does not have jobs for unskilled people, not anymore. It's only small business that does.

Representative RICHMOND. I would envison large business—knowing full well that certain people in the organization are going to retire a year from now, I would envision them taking on unemployable people for a year and giving them intensive training and then letting them replace that person who's going to retire a year later.

Mr. STEWART. I'm afraid you're asking too much.

Representative RICHMOND. Would small business do it?

Mr. STEWART. Yes; because small business doesn't take a year to train a new employee.

Representative RICHMOND. And also small business would be much more interested in the tax credit. How would you sell a program like that?

Mr. STEWART. You started to do that at the tailend of the CETA program which blew a lot of money because really it focused on the creation of government jobs or the creation of jobs in government-sized businesses, in both of which you don't create jobs for unskilled people except as a matter of dole.

In small business we train quickly for jobs that don't pay as well. To go back to the fellow you're most concerned about, the guy who's never had a job, the teenage black. Where is he more likely to get a learning experience in working which is going to stand him in good stead? In a company that has eight people and where he works day to day close to eight people, including the boss, or in an impersonal large company where he goes to the personnel outfit which is biased against him for a whole host of middle class reasons?

Learn from our own history. Where did our machine shop owners in the Middle West come from? Immigrants who worked on the bench alongside the boss. That's where you learn how to work in this country and that's where those people will learn how to work. The best combination I know of was in Chicago where the large companies financed a program for minority people, young people, but the jobs were created by small business. The big companies paid for the machinery, the office, the training, the rest of it, but the jobs were in small companies. Now this doesn't work 100 percent. You will get maybe 20 percent of the people you put to work for the first time who will stay where they are put to work. The rest of them will disappear. After the second job experience, another 15 or 20 percent will have learned enough to stay. It takes great patience. We're trying to do for such people in one generation what normally takes three.

Representative RICHMOND. However, every time we do it for one of these people we're making him into a taxpayer instead of a taxtaker.

Mr. STEWART. Absolutely.

Representative RICHMOND. And more than likely, we're taking him out of the criminal element of society.

Mr. STEWART. Let me just put on the record some things. The only people who make jobs in America are entrepreneurs. They are the people who start businesses, raise the money and take the risk, who see a market niche and who hire the people for the job. Unless you start with the question of how we expand the entrepreneurial climate, how do we get more people to go into business and stay in business, how do we get more small business——

Representative RICHMOND. What's the rate of small business going in nowadays?

Mr. STEWART. We create a half a million new starts of businesses a year.

Representative RICHMOND. How is that compared to prior years?

Mr. STEWART. It's still going up numerically. Relatively, in terms of number of people, it's fine. But don't let that fool you.

Representative RICHMOND. Let me take it all the way through. In other words, you're saying that small business formations are continuing to grow year after year?

Mr. STEWART. Before you got here, Congressman Richmond, I showed a chart which indicated the young people in this country want to be self-employed.

Representative RICHMOND. Sure. So small businesses are continuing to be organized every year.

Mr. STEWART. Yes.

Representative RICHMOND. But the rate of bankruptcies, as we know, is up, and the people who usually go bankrupt are the small businesses. One hardly ever hears of a large business going bankrupt because they sell it or merge it or something. So small business formations are up?

Mr. STEWART. Yes.

Representative RICHMOND. What could Government do in the way of a tax-incentive program to get small business to hire the unemployable people with the understanding that these people not only require job training but job habit training, and they frequently require English and math remediation. For example, Government really should supply teachers at these small businesses every single night for the kids to have about 2 hours of training.

Mr. STEWART. Let me answer your question in two ways, narrowly and specifically first. Go back to the job tax credit.

Representative RICHMOND. Job tax credit.

Mr. STEWART. Job tax credit. For 1 year to every employer who created a job more than he had in the preceding 2 or 3 years, we gave him a credit on his tax return of $1,800. We then took it away and we said, we're going to limit it only to those people—we're going to target it to black people, to people in ghettos, to criminals, to people who need jobs the most. We narrowed the focus of that tax credit so much that no small business with any sense would make use of it. It's too much trouble, too hard to use. We walked away from a good approach. That's one specific answer. It's not the only one.

You can, I think, by a more judicious use of training dollars, putting them into small business, you can do a better job than you've done, but there's a more general answer you must not walk away from. I think you have to resist the temptation for trying to do the hardest thing first, last and always. What you want to get at is the black kid in the ghetto who's shooting himself up with drugs and who's never had a job, and the fifth generation on welfare. Why do you make it so tough?

Representative RICHMOND. You know what that man costs you every year?

Mr. STEWART. A great deal. Let me tell you why I don't think that——

Representative RICHMOND. Do you know what that man costs society every year? Many hundreds of thousands of dollars. If we could remove that man from his life of crime and put him into a paying job, we have not only built him up and his family, but you would also save society countless hundreds of thousands of dollars because that man will commit five crimes before he's caught and the prison term alone costs $30,000 a year.

Mr. Stewart. I agree with you.

Representative Richmond. He'll probably cause at least $2,000 or $3,000 worth of damage in health and material before he is caught and that's an enormous amount of money. His family then goes on welfare. The whole spiral effect is mind-boggling. If we could take that one person and put him to work and train him and teach him English and arithmetic and job habits, even if it costs a few thousand dollars, just think what we would save.

Mr. Stewart. The difficulty with starting there, Congressman Richmond, is we're not good enough. We don't know enough about how to do it and we're not prepared to pay the price or do the job. We have to do more general things to help that happen and we have to not walk away from those things because they won't help everybody overnight in the ghetto to stop taking drugs.

California has a 13-percent tax which applies to capital gains as well as income. This year the California legislature and the Governor eliminated that tax on gains made in small companies if the investments are kept in the businesses for 3 years. I think that's a great model for the Federal Government and I think Congress should quit worrying if some middle class white Protestants are going to be helped by it as well as kids in ghettos. If you help everybody, you will help those ghetto kids too. You've got to do both. That's one of the big difficulties in getting sensible legislation out of Congress. You've got people who are concerned only about the most difficult problem in the world and they say, "If I can't solve that, don't talk to me." Then you've got the people who say, "Walk away from those people and worry only about the big picture." I say you've got to do both and you mustn't look for complete answers in either direction. It's an imperfect world. We've got to do the best we can.

Representative Richmond. Mr. Stewart, as you know, in your city of Boston and my city of New York, the major problem we both have is the damage and the havoc and the change of social habits caused by a small minority of young people. What I'd like to do is target those young people and try to get them into work habits and get them off the streets.

Mr. Stewart. So would I.

Representative Richmond. And I'm sure the Government will pay a substantial amount of that money if we could once and for all bring the right facts and figures to our House and Senate.

Mr. Stewart. With all due respect, Mr. Richmond——

Representative Richmond. We've tried it in New York. We operated a number of youth employment training programs. We have been most successful. We found better than 50 percent of our students stay employed, and before, each and every one of them was unemployable and it takes you a year to do it.

Mr. Stewart. Once again, I do not disagree with anything you're suggesting except your reliance on that to the exclusion of general policy.

Representative Richmond. Let's take Boston. In the city of Boston, which we both know very well, how would you actually do what you just said in Boston?

Mr. STEWART. The thing we need most in Boston—and incidentally, Boston is not in as bad a shape as many other cities. We've got a small business economy growing that won't quit.

Representative RICHMOND. But you've got areas in Boston where people won't even make a delivery.

Mr. STEWART. Well, I don't have any simple answer overnight about what to do about some areas.

Representative RICHMOND. I used to live there too.

Mr. STEWART. I lived in New York for a long time and, slum for slum, the cities of this country are a disgrace in terms of neglect and a lot of other things, and we can worry about it as long as we want to, but we're not going to clean them up overnight simply by training people in them. We're going to have to create jobs for them. You don't create jobs without creating business, unless you want them on the public payroll. The people who create jobs are entrepreneurs.

Representative RICHMOND. You know, in New York City we have just as many open jobs right now as we have unemployed people. We have 300,000 open jobs and 300,000 unemployed people.

Mr. STEWART. No question about it.

Representative RICHMOND. There's no shortage of jobs in the United States. There's a shortage of trained people. Why doesn't somebody figure out that the real problem is to take these unemployable people and put enough money into training them and put them into these job openings that we have in small business? And I agree with you that small business is the best medium to do that through.

Mr. STEWART. Let me just tell you I can't quarrel with the logic of what you're saying. All I can tell you is that there's another New Yorker who we both know very well, who is Pat Moynihan, who's not always foolish about the world. He once said, "If you want to get a good thing done in this country, let somebody make a buck out of it."

Representative RICHMOND. Mr. Stewart, I agree that small business should make a buck out of employing an unemployable person, training him and making him into a decent worker. All I want is some type of modus operandi that we could consider. I'm not just on this committee, but I'm on the House Small Business Committee.

Mr. STEWART. The best example I can give you is the model in Chicago where Mr. Fitzpatrick is now executive vice president of the National Business Association. I wish I could give you an easy answer, but you know what you're going to bump into. To spend the kind of money you want to without creating wealth at the same time, you're going to raise a lot of hob with a whole lot of other public finance problems.

Representative RICHMOND. What would you do with tax credits?

Mr. STEWART. Again, I've given you the best answer I can come up with, which is a job tax credit that really works; not what we have now, which is inadministerable, ineffective. Encourage small business to invest in more jobs for the kind of people you want to hire.

Representative RICHMOND. I don't believe large business would particularly want to do that for an $1,800 tax credit.

Mr. **Stewart**. Not at all.

Representative **Richmond**. You say small business would? They would take an unemployable person and actually train him for an $1,800 tax credit?

Mr. **Stewart**. I believe they would, if you don't make it too hard. Let me tell you where the cheese starts to get binding. I have talked to as many small businessmen about this problem as probably anybody in this country and I have seen in at least one case—a major corporation offered a city $250,000 for employment activities for minority groups in that city for the summer, youngsters. The day I got to that city I was going to talk to the chamber of commerce counsel, and those fellows did not want to take the money. And I said, "Why not?" They said, "Do you know what we have to go through with a CETA employee? Do you know how many pieces of paper we have to file? Do you know what kind of certificates we have to make? Do you know how many times we have to swear our lives away? What does it do to our exisiting payroll if we have to pay that kid more than the people working there already?"

We're trying to do too much too fast. We're trying to satisfy too may needs. For example, take your proposal. What is the trade union movement in this country, which historically used to do things for poor people, going to say? The first thing it will say is, "Pay that kid the prevailing rate." Right?

Representative **Richmond**. After his training, not during the first year.

Mr. **Stewart**. They won't even give you that.

Representative **Richmond**. Most of these small businesses aren't unionized anyway.

Mr. **Stewart**. That's the saving grace.

Representative **Richmond**. So don't bring in the union.

Mr. **Stewart**. Well, I do because when it comes time to run the CETA program, they run it. It's their people in the Labor Department. It's their people locally. And again, I don't have a thing against them as people, but what they really try to do is control access to the labor force to protect their preferred wage rates.

Representative **Richmond**. Certainly the unions wouldn't require the prevailing wage during the training program. We run four of these programs in New York City now and we find they work.

Mr. **Stewart**. As a lifelong Democrat, I have for 15 years been in favor of a two-step minimum wage. Find me a union leader who's in favor of it. Find me one who's willing to say, "For that kid to put him on the workbench, a kid who's done nothing but make trouble all his life, don't make the boss pay him the same wage as somebody who's been working there 20 years."

Representative **Richmond**. Obviously, during the first year, we can't pay the prevailing wage.

Mr. **Stewart**. Get a minimum wage that allows that differentiation—first 5 years or first 5 months, I don't care. Make it easy for people. Make it easy for entrepreneurs, not hard. Don't ask them to do it just because it's a good thing to do. I'll tell you why. When they look at their government and government-sized businesses, they don't do many things just because they're good things to do. Don't ask us to do them. Ask us to do them because they make sense. When you say they will save tax dollars, that's a good reason. If you also say, we'll make it worth your while as a business matter, that's a good reason.

Representative RICHMOND. Well, Mr. Stewart, the happy part of this is that the Deputy Secretary of Commerce Joe Wright, who's been an industrialist in New York City for many years, would like our committee to run a series of indepth hearings with the Secretaries of Commerce and Labor and see if we could structure some type of new job training program that will actually work and hopefully we'll get those hearings off in the next few weeks. I'm sure you will be interested in them. Those job training programs will have to be directed toward small business.

Mr. STEWART. Let me say one more thing, Congressman Richmond, because I think I know where you come from on this particular issue. Again, don't ask small business to do things it can't do. If you create a national environment which makes it easier for small business people to survive and grow and does something about the bankruptcy rates, you've got a 50 percent better chance.

Representative RICHMOND. Now you're talking about interest rates?

Mr. STEWART. I'm talking about taxes and regulations and foreign trade. You've got to deal with all of them.

Representative RICHMOND. Mr. Stewart, I've never seen taxes in my life cause a small business to go broke. I can say interest rates, yes; foreign competition, yes.

Mr. STEWART. I'll bring you some cases.

Representative RICHMOND. I don't believe taxes will destroy a small business.

Mr. STEWART. I don't think it helps much to narrow in on the area we disagree on. There are businesses that do not survive because of the level of taxes they have to pay. There are competitive reasons for it always, but that's a factor too I think. Whether that's right or wrong, taxes are only one thing the Government does. Capital, credit, regulation, a variety of things come back to here in terms of national policy. If you want to deal with the problem, then I do too, and I'm willing to help you deal with that specific one if you will see it as part of the general problem of the future of small business in this country, squeezed as it is between government and government-sized business. But if you want us to assume a burden and a responsibility, do something to make it possible for us to do it.

Representative RICHMOND. Thank you, Mr. Stewart. I think, by and large, you and I are in agreement. I hope you will attend these hearings we plan to have because I still feel that job training by small businesses would be one of the best things we could possibly do in this country and they can use tax credits or——

Mr. STEWART. Get them for them, and we'll do the best we can.

Representative RICHMOND. As you said, it's so much easier for a young person to fit in with an organization with 10, 12, or 30 people rather than an organization of 5,000 people.

Mr. STEWART. No doubt about it.

Representative RICHMOND. Thank you.

This subcommittee is adjourned.

[Whereupon, at 11:35 a.m., the subcommittee adjourned, subject to the call of the Chair.]

[The following information was subsequently supplied for the record:]

STATEMENT OF NEIL L. PRUITT, PRESIDENT, NATIONAL ASSOCIATION OF RETAIL DRUGGISTS

Economic Impact of Government Competition with Small Business

Mr. Chairman :

The National Association of Retail Druggists (NARD) represents owners of more than 30,000 independent retail pharmacies, where over 75,000 pharmacists dispense more than 70 percent of the nation's prescription drugs. Together, they serve 18 million persons daily. NARD has long been acknowledged as the sole advocate for this vital component of our free-enterprise system.

NARD members are primarily family businesses. They have roots in America's communities. The neighborhood independent druggist typifies the reliability, stability yet adventuresomeness that has made our country great.

As owners of independent pharmacies, our members are committed to legislative and regulatory initiatives designed to provide them a fair chance to compete. Essential, to this primary objective, is elimination of unfair government competition.

Our members, who with other small businesses are the backbone of the economy providing 90% of all new jobs, are concerned about competition in health care. In particular, competition with government!

It is NARD's position that no citizens should tolerate a government allocation of their taxes for projects or programs that compete with the sources of the said tax revenue, namely, the enterprising efforts of small business, in this instance, independent retail pharmacies.

An especially obvious example of govenment competition with the independent retail druggist is the Veterans Administration. The VA has a prescription drug program for veterans. The veterans must go to a VA facility or use the mail for prescription drugs. One of NARD's priorities for the 97th Congress is to see legislation enacted which would assure that veterans are provided the quality of pharmaceutical services to which they are entitled, rather than the present VA program which relegates our veterans to third class citizenship.

NARD supports the following priorities in VA Drug Program legislation:

1. Any veteran who is not a patient in a VA facility has a choice of the source of needed pharmaceutical services.

2. No longer will those who so ably served our country be forced to go to a VA facility or use the mail for prescription drugs.

3. No longer, as studies by the Disabled American Veterans have shown, will veterans have to wait more than four hours for a prescription to be filled, resulting in a loss of an entire day, when travel time is included.

4. No longer will the veterans who either cannot afford to, or are otherwise unable to travel to distant VA facilities, be forced to use the mails. Studies have documented that veterans are sent the wrong prescriptions, with incorrect or inaccurate instructions, experience -- as we all know -- excessive delays, are sent prescriptions that are no longer being approved by the physician.

In early post World War II years, veterans obtained quality pharmaceutical services, underthe VA "home town planning" directly from their neighborhood pharmacy. Unfortunately, this partnership between government and the private sector has been replaced with a massive Federal bureaucracy that denies quality care to veterans, while competing directly with small business.

NARD's goals would be met by H.R. 3536, introduced by the distinguished Ranking Minority Member of the House Veterans' Affairs Committee, John Paul Hammerschmidt (R-Ark). Charles M. West (Little Rock, Ark.) Chairman of NARD Committee on National Legislation and Government Affairs hailed the new bill as: "A landmark in the NARD drive to eliminate small business competition with the most unfair of all competitors: the Federal Government!" We urge each member of the Subcommittee and Joint Committee to support H.R. 3536.

Another area of government competition with small retail pharmacy owners involves federally-funded Health Maintenance Organizations (HMO's). Independent retail pharmacists have a number of tough competitors -- chains, mass merchandisers, other independents for starters. The Federal Government, however, is, as mentioned, the toughest and most unfair of all competitors.

Federally-funded HMO's are competing with the independent pharmacist in many areas. They are involved in forcing these small businesses into bankruptcy with policies which deny patients the freedom to choose their provider of pharmaceutical services.

NARD does not necessarily disagree with the HMO concept, but NARD steadfastly objects to federal policy or laws that deny HMO subscribers the dignity of freedom of choice. NARD also opposes regulations which allow HMO's to provide services to non-HMO subscribers, particularly in view of the HMO's drug purchases at discriminatory prices.

Consumer freedom of choice for pharmaceutical services should be incorporated in all federally-funded programs providing these services, including family planning, venereal disease and mental health clinic programs. Understandably, the retention of freedom of choice in other federal programs such as Medicaid is a top priority.

Whether it be the Veterans Administration drug program, HMO's, mental health, family planning or a myriad of other areas, it seems that every time our members turn around the Federal government has funded another high overhead, inefficient program to compete with them. Just as home ownership appears to be on the wane, such policies are eroding another component of the American Dream: owning your own business.

We commend you for scheduling these hearings on the subject of government competition with small business. We feel confident that these hearings will help to further expose this grave problem to the Congress and the public, and lay the groundwork for worthwhile progress towards finding the proper prescription for eliminating government competition with small business. NARD certainly shares the concerns expressed today by the other witnesses, OMB Director Stockman and former Small Business Chief Advocate now the publisher of Inc. magazine. Mr. Stewart said it as succinctly as any one, when he stated in his introduction to Government Competition: A Threat to Small Business, March, 1980 that the:

> "...central concern is the use Government has made of its authority to tax-supported instrumentalities which engage in direct economic competition with small, private, for-profit enterprises."

Let's not establish any more barriers to small businesses that are currently struggling with unconscionable interest rates and inflation. Help us assure that government will work through the free enterprise system, not in competition with it.

Our members are major factors in the stability of their hometowns. They are not newcomers or employees on the ladder to stardom in some distant chain's hierarchy. They know their employees and customers. Often they provide the success models or symbols to young, and not so young, of proof that the American dream of ownership and hard work is still what this country is all about. They support religious endeavors and other local institutions. In other words, they are leaders with a stake in the community who have, and are demonstrating daily, a commitment to local and national pride. They learned long ago that "Big is not necessarily better!"

All that they epitomize is under fire. Regretfully, the Federal Government is firing most of the shots!

Uppermost, our members want to continue owning and operating their pharmacies, providing vital, personalized health-care services for each of our communities.

The Officers, Executive Committee, and NARD staff stand ready to assist the Joint Economic Committee in any mutual effort which well permit small business, independent retail pharmacy in particular, to continue to control their own economic and professional destinies.